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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 842

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, PETITIONER

vs.

WESTERN MARYLAND RAILWAY COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 7, 1933
CERTIORARI GRANTED APRIL 24, 1933

(37539)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

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GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, PETITIONER

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WESTERN MARYLAND RAILWAY COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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TRANSCRIPT OF RECORD

UNITED STATES OF AMERICA,
DISTRICT OF MARYLAND, To-wit:

At a District Court of the United States for the District of Maryland, begun and held in the City of Baltimore on the first Tuesday in September, (being the 1st day of the same month) in the year of our Lord one thousand nine hundred and thirty-one.

Present: The Honorable William C. Coleman, Judge Maryland District; Simon E. Sobeloff, Esq., Attorney; George W. Collier, Esq., Marshal; Arthur L. Spamer, Clerk.

Among other were the following proceedings, to-wit:

Western Maryland Railway Company, a corporation, *vs.* Galen L. Tait, Collector of Internal Revenue of the United States for the District of Maryland.	No. 4172 Law.
Western Maryland Railway Company, a corporation, *vs.* The United States of America.	No. 4174 Law.
Western Maryland Railway Company, a corporation, *vs.* The United States of America.	No. 4177 Law.
Western Maryland Railway Company, a corporation, *vs.* Galen L. Tait, Collector of Internal Revenue of the United States for the District of Maryland.	No. 4469 Law. Consolidated Cases.

AMENDED DECLARATION, NO. 4172 LAW.

(2) Filed 2nd April, 1932.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.

Law No. 4172.

Plaintiff, Western Maryland Railway Company, a corporation organized and existing under the laws of the State of Maryland, by this its Amended Declaration, sues Galen L. Tait, Collector of Internal Revenue of the United States for the District of Maryland, for that:

COUNT ONE.

Plaintiff in compliance with the Act of Congress approved February 24, 1919, otherwise known as the Revenue Act of 1919, duly filed its annual income tax return for the calendar year 1920, and paid to defendant the amount of income tax shown thereby to be due, in equal quarterly installments, to wit: on or about March 15th, June 15th, September 15th and December 15th, 1921.

That prior to said year, plaintiff had sold its First Mortgage 4% Gold Bonds, maturing October 1, 1952, in the face amount of $46,633,000, at a total discount of $3,638,451.67. That amortizing said discount by spreading the same *rateably* over the life of said bonds, the yearly proportion thereof apportionable to said year 1920 was, and still is $80,796.24.

Plaintiff avers that under the aforementioned Revenue Act of 1919 and the regulations appertaining thereto, it was, and still is, entitled to deduct said $80,796.24 from its gross income for said calendar year 1920. That plaintiff erroneously failed to make said deduction in its return, and at the tax rate of 10% applicable for said
(3) year 1920 has erroneously paid to defendant the

sum of $8,079.62 as income taxes in excess of the amount lawfully due and payable by the plaintiff.

That plaintiff has duly filed its claim for refund of said $8,079.62 with the Commissioner of Internal Revenue upon the grounds above alleged, but said Commissioner has refused and continues to refuse to refund or repay said sum to the plaintiff.

Plaintiff, therefore, alleges that by reason of said presents defendant became, and still is, liable to plaintiff in the sum of $8,079.62, with interest from the date of payment thereof.

COUNT TWO.

And for that plaintiff in compliance with the Act of Congress approved November 23, 1921, otherwise known as the Revenue Act of 1921, duly filed its annual income tax return for the calendar year 1921, and paid to defendant the amount of income tax shown thereby to be due, in equal quarterly installments, to wit: on or about March 15th, June 15th, September 15th and December 15th, 1921.

That prior to said year plaintiff had sold its First Mortgage 4% Gold Bonds, maturing October 1, 1952, in the face amount of $46,633,000, at a total discount of $3,638,451.67. That amortizing said discount by spreading the same *rateably* over the life of said bonds, the yearly proportion thereof apportionable to said year 1921 was, and still is, $80,796.24.

Plaintiff avers that under the aforementioned Revenue Act of 1921 and the regulations appertaining thereto, it was, and still is, entitled to deduct said $80,796.24 from its gross income for said calendar year 1921. That plaintiff erroneously failed to make said deduction in its return, and at the tax rate of 10% applicable for said year 1921 has erroneously paid the defendant the sum of $8,079.62 as income taxes in excess of the amount lawfully due and payable by the plaintiff.

That plaintiff has duly filed its claim for refund of (4) said $8,079.62 with the Commissioner or Internal Revenue upon the grounds above alleged, but said Commissioner has refused and continues to refuse to refund or repay said sum to the plaintiff.

Plaintiff, therefore, alleges that by reason of said

presents defendant became and still is liable to plaintiff in the sum of $8,079.62 with interest from the date of payment thereof.

COUNT THREE.

And for that plaintiff in compliance with the Act of Congress approved November 23, 1921, otherwise known as the Revenue Act of 1921, duly filed its annual income tax return for the calendar year 1922 and paid to defendant the amount of income tax shown thereby to be due, in equal quarterly installments, to wit: on or about March 15th, June 15th, September 15th and December 15th, 1921.

That prior to said year plaintiff had sold its First Mortgage 4% Gold Bonds, maturing October 1, 1952, in the face amount of $46,633,000, at a total discount of $3,638,451.67. That amortizing said discount by spreading the same *rateably* over the life of said bonds, the yearly proportion thereof apportionable to said year 1922 was, and still is, $80,796.24.

Plaintiff avers that under the aforementioned Revenue Act of 1921 and the regulations appertaining thereto, it was, and still is, entitled to deduct said $80,796.24 from its gross income for said calendar year 1922. That Plaintiff erroneously failed to make said deduction in its return, and at the rate of 12½% applicable for said year 1922 has erroneously paid the defendant the sum of $10,099.53 as income taxes in excess of the amount lawfully due and payable by the plaintiff.

That plaintiff has duly filed its claim for refund of said $10,099.53 with the Commissioner of Internal Revenue upon the grounds above alleged, but said Commissioner has refused and continues to refuse to refund or repay said sum to the plaintiff.

Plaintiff, therefore, alleges that by reason of said presents defendant became and still is liable to plaintiff (5) in the sum of $10,099.53 with interest from the date of payment thereof.

Wherefore, plaintiff brings this suit and claims as damages the sum of $50,000.00.

EUGENE S. WILLIAMS,
Attorney for Plaintiff.

To the Defendant:

Take notice, that in accordance with the rules of the United States District Court for the District of Maryland, you will be required to plead to the above Declaration before the return day subsequent to that to which you may be summoned, or else judgment by default may be entered against you.

EUGENE S. WILLIAMS,
Attorney for Plaintiff.

PLEAS.

(6) Filed 28th May, 1931.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
} Law No. 4172.

The defendant, Galen L. Tait, Collector of Internal Revenue for the District of Maryland, by Simon E. Sobeloff, United States Attorney, says for pleas to the declaration and the amended declaration, and to each and every count thereof:

1. That he never promised as alleged.

2. That he is not indebted as alleged.

SIMON E. SOBELOFF,
United States Attorney.

DECLARATION NO. 4174 LAW.

(7) Filed 2nd December, 1929.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,

vs.

The United States, Defendant.

Western Maryland Railway Company, a corporation organized and existing under the laws of the State of Maryland, by George P. Bagby and Eugene S. Williams, its attorneys, sues The United States,

For money due and payable by the defendant to the plaintiff.

1. For money received by the defendant for the use of the plaintiff.

2. For money found to be due by the defendant to the plaintiff on accounts stated between them.

THIRD COUNT.

For that the plaintiff, whose principal office is, and at the times hereinafter referred to was, located at Baltimore, Md., in compliance with an Act of Congress known as the Revenue Act of 1919, duly filed its annual income tax return for the year 1920 with Joshua W. Miles, then Collector of Internal Revenue for the District of Maryland, but now deceased, and paid to the said Joshua W. Miles the amount of income taxes shown in said return to be due, in equal quarterly installments, on March 15th, June 15th, September 15th and December 15th, 1921.

Plaintiff avers that said return was erroneous and showed taxes to be due in excess of the amount actually and legally due for the year 1920 in that, in computing the taxable income so reported for said year, plaintiff failed to deduct from its gross income any portion of the discount at which certain of its mortgage bonds, bearing maturity date of October 1, 1952, were sold prior

(8) to said year 1920, which said discount aggregated $3,638,451.67. Plaintiff further avers that for the year 1920, and at the time said bonds were sold, its income accounts were, and ever since have been, kept on an accrual basis; that under the provisions of the said Revenue Act and the Regulations of the Treasury Department of the United States issued under said Act, plaintiff was and is entitled to amortize said discount, in arriving at its taxable income, by spreading said discount over the life of the bonds and deducting the yearly proportion thereof from its gross income; that the annual proportion of said discount, so spread *rateably* over the life of the bonds, is $80,796.24; that the tax rate applicable to the tapable income for said year 1920 was 10 per cent and that plaintiff, therefore, erroneously paid to defendant the sum of $8,079.62 in excess of taxes lawfully due and payable by the plaintiff.

Plaintiff, on or about the 5th day of January, 1925, filed with Galen L. Tait, then Collection of Internal Revenue for the District of Maryland, its claim for refund of the said sum of $8,079.62 and interest thereon from dates of payment, but defendant has failed and refused, and does now refuse, to refund or pay said sum to plaintiff.

Plaintiff, therefore, alleges that defendant became, and is, liable to the plaintiff in the aforesaid sum of $8,079.62, with interest thereon from dates of payment as aforesaid. Wherefore, plaintiff brings this suit and claims $15,000 damages.

GEORGE P. BAGBY,
EUGENE S. WILLIAMS,
Attorneys for Plaintiff.

To the Defendant—

Take notice, that in accordance with the rules of the United States District Court for the District of Maryland, you will be required to plead to the above Declaration before the return day subsequent to that to which you may be summoned, or else judgment by default may be entered against you.

GEORGE P. BAGBY,
EUGENE S. WILLIAMS,
Attorneys for Plaintiff.

PLEAS.

(9) Filed 28th May, 1931.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
The United States, Defendant. } Law 4174.

The defendant, the United States, by Simon E. Sobeloff, United States Attorney, says for pleas to the declaration and to each and every count thereof:

1. That the defendant never promised as alleged.

2. That the defendant is not indebted as alleged.

SIMON E. SOBELOFF,
United States Attorney.

DECLARATION, IN NATURE OF PETITION, NO. 4177 LAW

(10) Filed 3rd December, 1929.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Petitioner,
vs.
The United States, Respondent.

To the Honorable the District Court of the United States for the District of Maryland:

The petitioner, Western Maryland Railway Company, respectfully represents:

1. That petitioner is a corporation organized and

existing under the laws of the State of Maryland, and that its principal office is in Baltimore, Md.

2. That petitioner, in compliance with an Act of Congress known as the Revenue Act of 1919, duly filed its annual income tax return for the year 1920 with Joshua W. Miles, then Collector of Internal Revenue for the District of Maryland, but now deceased, and paid to the said Joshua W. Miles the amount of income taxes shown in said return to be due, in equal quarterly installments, on March 15th, June 15th, September 15th and December 15th, 1921.

3. Petitioner further represents that said return was erroneous and showed taxes to be due in excess of the amount actually and legally due for the year 1920 in that, in computing the taxable income so reported for said year, petitioner failed to deduct from its gross income any portion of the discount at which certain of its mortgage bonds, bearing maturity date of October 1, 1952, were sold prior to said year 1920, which said discount aggregated $3,638,451.67. Petitioner further represents that for the year 1920, and at the time said bonds were sold, its income accounts were, and ever since have been, kept on an accrual basis; that under the provis-
(11) ions of the said Revenue Act and the Regulation of the Treasury Department of the United States issued under said Act, petitioner was and is entitled to amortize said discount, in arriving at its taxable income, by spreading said discount over the life of the bonds and deducting the yearly proportion thereof from its gross income; that the annual proportion of said discount, so spread *ratably* over the life of the bonds, is $80,796.24; that the tax rate applicable to the taxable income for said year 1920 was 10 per cent and that petitioner, therefore, erroneously paid to said Joshua W. Miles, as Collector of Internal Revenue as aforesaid, the sum of $8,079.62 in excess of taxes lawfully due and payable by the petitioner.

4. That petitioner, on or about the 5th day of January, 1925, filed with Galen L. Tait, then Collector of

Internal Revenue for the District of Maryland, its claim for refund of the said sum of $8,079.62 and interest thereon from dates of payment, but respondent has failed and refused, and does now refuse, to refund or pay said sum to petitioner.

Wherefore, petitioner prays judgment for such sum of money that may be justly due and owing it, amounting to $8,079.62 with interest thereon from date of payment as aforesaid, and such further and other relief to which it may appear petitioner is entitled.

WESTERN MARYLAND RAILWAY COMPANY,
By S. R. GEHLERT, Treasurer.

GEORGE P. BAGBY,
EUGENE S. WILLIAMS,
Attorneys for Petitioner.

STATE OF MARYLAND,
(12) City of Baltimore, To-wit:

S. R. Gehlert, being first duly sworn on oath, deposes and says that he is the Treasurer of the above named petitioner, and has knowledge of the matters and things above set forth; that each of the allegations contained in above Petition are true both in substance and in fact, to the best of his knowledge, information and belief.

S. R. GEHLERT.

Subscribed and sworn to before me this 3rd day of December, 1929.

G. I. CHARLTON,
(Notarial Seal) Notary Public.

My Commission expires May 1931.

AFFIDAVIT OF SERVICE.

(13) Filed 6th December, 1929.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Petitioner,

vs.

The United States, Respondent.

STATE OF MARYLAND,
City of Baltimore, To-wit:

We hereby certify that on the 3rd day of December, 1929, we caused a copy of the Petition filed in the above styled proceeding to be served upon Amos W. W. Woodcock, District Attorney of the United States for the District of Maryland, and on the same date mailed a copy of said Petition by registered letter to the Attorney General of the United States.

GEORGE P. BAGBY,
EUGENE S. WILLIAMS,
Attorneys for Petitioner.

Subscribed and sworn to before me this 3rd day of December, 1929.

G. I. CHARLTON,
(Notarial Seal) Notary Public.

My commission expires May 1931.

AMENDED DECLARATION, NO. 4469 LAW.

(14) Filed 27th May, 1931.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,

vs.

Galen L. Tait, Collector of Internal Revenue, Defendant.

Law No. 4469.

Plaintiff, Western Maryland Railway Company, a

corporation organized and existing under the laws of the State of Maryland, by this its amended declaration, sues Galen L. Tait, Collector of Internal Revenue of the United States for the District of Maryland, for that:

FIRST COUNT.

Plaintiff, in compliance with the Act of Congress approved November 23, 1921, otherwise known as the Revenue Act of 1921, duly filed its annual income tax return for the calendar year 1923, and paid to defendant the amount of income tax shown thereby to be due, in equal quarterly installments to wit: March 15, June 14, September 15 and December 15, 1924.

Prior to said year 1923 plaintiff had sold its First Mortgage 4 Per Cent Gold Bonds, maturing October 1, 1952, in the principal amount of $46,633,000, at a total discount of $3,638,451.67. That amortizing said discount by spreading the same *rateably* over the life of said bonds, the yearly proportion thereof apportionable to said year 1923 was, and still is, $80,796.24.

Plaintiff avers that under the aforementioned Revenue Act of 1921, and the regulations appertaining thereto, it was, and still is, entitled to deduct said $80,796.24 from its gross income for said calendar year 1923. Plaintiff, in arriving at its taxable net income for said year, made said deduction accordingly. Subsequently, the Commissioner of Internal Revenue ordered an audit to be made of plaintiff's income tax return for said calendar year 1923, and, as a consequence thereof, disallowed said deduction to plaintiff, demanding payment of additional taxes upon said sum of $80,796.24 at the then prevailing tax rate of 12½%. Plaintiff, on or (15) about December 4, 1930, paid said additional tax, amounting to $10,099.53, under protest and in order to avoid imposition of heavy penalties and distraint upon its property.

Plaintiff has duly filed its claim for refund of said $10,099.53 with the Commissioner of Internal Revenue, upon the grounds above alleged, but said Commissioner has refused and continues to refuse to refund or repay said sum to plaintiff.

Plaintiff, therefore, alleges that by reason of said presents defendant became, and still is, liable to plaintiff in the sum of $10,099.53, with interest from the date of payment thereof.

SECOND COUNT.

Plaintiff, in compliance with the Act of Congress approved June 2, 1924, otherwise known as the Revenue Act of 1924, duly filed its annual income tax return for the calendar year 1924, and paid to defendant the amount of income tax shown thereby to be due in equal quarterly instalments, to wit: March 16, June 16, September 18, December 17, 1925.

Prior to said year 1924 plaintiff had sold its First Mortgage 4 Per Cent Gold Bonds, maturing October 1, 1952, in the principal amount of $46,633,000, at a total discount of $3,638,451.67. That amortizing said discount by spreading the same *ratably* over the life of said bonds, the yearly proportion thereof apportionable to said year 1924 was, and still is, $80,796.24.

Plaintiff avers that under the aforementioned Revenue Act of 1924, and the regulations appertaining thereto, it was, and still is, entitled to deduct said $80,796.24 from its gross income for said calendar year 1924. Plaintiff, in arriving at its taxable net income for said year, made said deduction accordingly. Subsequently, the Commissioner of Internal Revenue ordered an audit to be made of plaintiff's income tax return for said calendar year 1924, and, as a consequence thereof, disallowed said deduction to plaintiff, demanding payment of additional taxes upon said sum of $80,796.24 at the then prevailing tax rate of 12½%. Plaintiff, on or about December 4, 1930, paid said additional tax, amounting to $10,099.53, under protest and in order to avoid imposition of heavy penalties and distraint upon its property.

Plaintiff has duly filed its claim for refund of said $10,099.53 with the Commissioner of Internal Revenue (16) upon the grounds above alleged, but said Commissioner has refused and continues to refuse to refund or repay said sum to plaintiff.

Plaintiff, therefore, alleges that by reason of said

presents defendant became, and still is, liable to plaintiff in the sum of $10,099.53, with interest from the date of payment thereof.

THIRD COUNT.

Plaintiff, in compliance with the Act of Congress approved June 2, 1924, otherwise known as the Revenue Act of 1924, duly files its annual income tax return for the calendar year 1925, and paid to defendant the amount of income tax shown thereby to be due, in equal quarterly instalments to wit: March 16, June 16, September 16, December 16, 1926.

Prior to said year 1925 plaintiff had sold its First Mortgage 4 Per cent Gold Bonds, maturing October 1, 1952, in the principal amount of $46,633,000, at a total discount of $3,638,451.67. That amortizing said discount by spreading the same *rateably* over the life of said bonds, the yearly proportion thereof apportionable to said year 1925 was, and still is, $80,796.24.

Plaintiff avers that under the aforementioned Revenue Act of 1924, and the regulations appertaining thereto, it was, and still is, entitled to deduct said $80,796.24 from its gross income for said calendar year 1925. Plaintiff, in arriving at its taxable net income for said year, made said deduction accordingly. Subsequently, the Commissioner of Internal Revenue ordered an audit to be made of plaintiff's income tax return for said calendar year 1925, and, as a consequence thereof, disallowed said deduction to plaintiff, demanding payment of additional taxes upon said sum of $80,796.24 at the then prevailing tax rate of 12½%. Plaintiff, on or about December 4, 1930, paid said additional tax amounting to $10,099.53, under protest and in order to avoid imposition of heavy penalties and distraint upon its property.

Plaintiff has duly filed its claim for refund of said $10,099.53 with the Commissioner of Internal Revenue, (17) upon the grounds above alleged, but said Commissioner has refused and continues to refuse to refund or repay said sum to plaintiff.

Plaintiff, therefore, alleges that by reason of said presents defendant became, and still is, liable to plain-

tiff in the sum of $10,099.53, with interest from the date of payment thereof.

Wherefore, plaintiff brings this suit and claims as damages the sum of Fifty Thousand ($50,000.00) Dollars.

EUGENE S. WILLIAMS,
Attorney for Plaintiff.

To the Defendant—

Take notice, that in accordance with the rules of the United States District Court for the District of Maryland, you will be required to plead to the above Declaration before the return day subsequent to that to which you may be summoned, or else judgment by default may be entered against you.

EUGENE S. WILLIAMS,
Attorney for Plaintiff.

PLEAS.

(18) Filed 28th May, 1931.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
Law 4469.

The defendant, Galen L. Tait, Collector of Internal Revenue for the District of Maryland, by Simon E. Sobeloff, United States Attorney, says for pleas to the declaration and amended declaration and to each and every count thereof:

1. That he never promised as alleged.

2. That he is not indebted as alleged.

SIMON E. SOBELOFF,
United States Attorney.

STIPULATION OF COUNSEL WAIVING JURY TRIAL.

(19) Filed 28th May, 1931.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
Law No. 4172.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
The United States, Defendant.
Law No. 4174.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
Law No. 4469.

It is hereby stipulated and agreed by and between the parties to the above entitled causes, by their respective counsel of record, that a jury trial be waived and that the issues herein be tried by the Court without the aid or intervention of a jury.

EUGENE S. WILLIAMS,
Counsel for Plaintiff in Law Nos. 4172, 4174 and 4469.

SIMON E. SOBELOFF,
Counsel for Defendants in Law Nos. 4172, 4174 and 4469.

PETITION AND ORDER FOR CONSOLIDATION.

(20) Filed 28th May, 1931.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
The United States, Defendant.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.

To the Honorable Judge of said Court:

The petition of Western Maryland Railway Company, by Eugene S. Williams, its attorney, respectfully represents:

1. That there are pending on the law side of this Honorable Court three (3) suits filed by petitioner for the recovery of certain income taxes and which are more particularly described as follows:

(A) Western Maryland Railway Company *vs.* Tait, Docket No. 4172, consisting of three counts covering taxable years 1920, 1921 and 1922, each count alleging that plaintiff is entitled to recover certain overpayments of income taxes amounting in all to Twenty-Six Thousand Two Hundred Fifty-eight Dollars and Seventy-Seven Cents ($26,258.77).

(B) Western Maryland Railway Company *vs.* United States, Docket No. 4174, which consists of one

(21) count alleging overpayment of Eight Thousand Seventy-nine Dollars and Sixty-Two Cents ($8,079.62) of income taxes in the year 1920, said suit having been filed after the death of Joshua W. Miles, as Collector of Internal Revenue for the District of Maryland, and in order to name the United States as Defendant, and thereby to preserve plaintiff's rights of action for said year 1920.

(C) Western Maryland Railway Company *vs.* Tait, Docket No. 4469, which consists of three counts for the taxable years 1923, 1924 and 1925, and each of which alleges that plaintiff is entitled to recover certain overpayments of income taxes amounting in all to Thirty-Thousand, Two Hundred Ninety-Eight Dollars and Fifty-Nine Cents, ($30,298.59).

2. That in each of said suits identical questions of law are involved as well as identical matters of fact, which latter are covered by a stipulation of counsel to be filed in advance of the hearing.

3. That petitioner believes it will greatly facilitate the disposition of said suits if they may be consolidated and treated as one for the purposes of trial, verdict and judgment.

Wherefore petitioner prays that an order be passed consolidating the three suits at law herein described.

And as in duty bound.

EUGENE S. WILLIAMS,
Attorney for Petitioner.

Upon the foregoing petition and order, it is this 28th day of May, 1931, by the United States District Court in and for the District of Maryland

Ordered, that the suits at law entitled Western Maryland Railway Company *vs.* Tait, Docket No. 4172, Western Maryland Railway Company *vs.* United States, Docket No. 4175, and Western Maryland Railway Com-

pany *vs.* Tait, Docket No. 4469, be, and they are hereby consolidated.

WILLIAM C. COLEMAN,
United States District Judge.

PETITION AN DORDER OF COURT CONSOLIDATING CASE NUMBER 4177 LAW WITH CASES NUMBERS 4172, 4174 AND 4469 LAW DOCKET, TO TAKE EFFECT AS OF MAY 28TH, 1931.

(22) Filed 21st April, 1932.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company
vs.
The United States of America. } No. 4177.
Law Docket

To the Honorable Judges of said Court:

The petition of Western Maryland Railway Company, a corporation, by Eugene S. Williams, its attorney, represents:

1. That it has heretofore filed before this Court four (4) suits for the recovery of certain Income Taxes for the years 1920 to 1925 inclusive, as follows:

Law No. 4172, Western Maryland Railway Company *vs.* Tait,

Law No. 4174, Western Maryland Railway Company *vs.* The United States of America,

Law No. 4177, Western Maryland Railway Company *vs.* The United States of America,

Law No. 4469, Western Maryland Railway Company *vs.* Tait.

2. That by order of this Honorable Court dated May 28, 1931, three (3) of said suits, to wit: Nos. 4172, 4174 and 4469, were consolidated and thereafter tried as one (1), and a judgment rendered in favor of petitioner in all suits as consolidated, on October 22, 1931.

3. Law Nos. 4177 and 4174 both seek recovery of Income Taxes for the year 1920 and are identical in every respect except that 4177 is filed in the form of a petition, and 4174 in the form of a declaration, these said suits having been separately instituted in order to preserve petitioner's rights to recover Income Taxes for said year by making the United States a party defendant, the Collector of Internal Revenue, the Honorable Joshua (23) W. Miles, being at that time deceased.

4. That Law No. 4177 was by inadvertence omitted from the petition for an order of consolidation aforementioned, and is therefore now standing open upon Law Docket, assigned for trial April 12, 1932.

Wherefore, petitioner prays that inasmuch as all questions involved in said Law No. 4177 have been determined by the judgment rendered on October 22, 1931, the said suit be ordered consolidated with the other three (3) suits hereinbefore mentioned.

And as in duty bound, etc.

EUGENE S. WILLIAMS,
Attorney for Petitioner.

I hereby assent to the passage of an order as prayed.

SIMON E. SOBELOFF,
U. S. Attorney.
E. H. M.

The foregoing petition having been read and considered, it is by the United States District Court, in and for the District of Maryland, this 21st day of April, 1932, ordered that the proceeding entitled Western Mary-

land Railway Company *vs.* The United States of America, and numbered 4177 upon the Law Docket of this Court be, and the same is hereby, consolidated with Law Nos. 4172, 4174 and 4469, heretofore consolidated by order dated May 28, 1931; and it is further ordered that this order of consolidation take effect as of May 28, 1931.

WILLIAM C. COLEMAN,
United States District Judge.

DEFENDANT'S REQUEST FOR FINDING OF FACTS.

(24) Filed 28th May, 1931.

Western Maryland Railway Company, a corporation, Plaintiff, *vs.* Galen L. Tait, Collector of Internal Revenue, Defendant.	Law No. 4172
Western Maryland Railway Company, a corporation, Plaintiff, *vs.* The United States, Defendant.	Law No. 4174.
Western Maryland Railway Company, a corporation, Plaintiff, *vs.* Galen L. Tait, Collector of Internal Revenue, Defendant.	Law No. 4469.

It is requested that the Court make and return in the above-mentioned cases special finding of facts in the manner of and as set forth in the stipulation of facts filed herein.

SIMON E. SOBELOFF,
Attorney for Defendants.

DEFENDANT'S REQUEST FOR CONCLUSIONS OF LAW.

(25) Filed 28th May, 1931.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
Law No. 4172

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
The United States, Defendant.
Law No. 4174.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
Law No. 4469.

It is requested that the Court find and return as a conclusion of law that the plaintiff, in the determination of his tax liability for the years in question, is not entitled to amortize and deduct from income for said years any portion of the bond discount herein involved.

SIMON E. SOBELOFF,
Attorney for Defendants.

DEFENDANT'S MOTION FOR VERDICT.

(26) Filed 28th May, 1931.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
Law No. 4172

Western Maryland Railway Company, a corporation, Plaintiff, *vs.* The United States, Defendant.	Law No. 4174.
Western Maryland Railway Company, a corporation, Plaintiff, *vs.* Galen L. Tait, Collector of Internal Revenue, Defendant.	Law No. 4469.

The defendants herein, and each of them, move the Court for judgment in favor of the defendants.

SIMON E. SOBELOFF,
Attorney for Defendants.

PLAINTIFF'S PRAYERS.

(27) Filed 28th May, 1931.

PLAINTIFF'S 1ST PRAYER.

Plaintiff prays the Court to instruct itself that under all of the evidence presented in the case the verdict must, as a matter of law, be for the plaintiff.

PLAINTIFF'S 2ND PRAYER.

Plaintiff prays the Court to instruct itself that the issue involved in this case is the same issue as has already been determined in a previous proceeding between plaintiff and defendants or their privy.

PLAINTIFF'S 3RD PRAYER.

Plaintiff prays the Court to instruct itself that the issue involved in this case has heretofore been adjudicated in favor of the plaintiff, and that the judgment in this case, must, therefore, be for the plaintiff.

PLAINTIFF'S 4TH PRAYER.

Plaintiff prays the Court to instruct itself that all of the evidence presented relating to the reorganization as of January 1, 1910, and the evidence relating to any differences between Western Maryland Rail Road Company *the* The Western Maryland Railway Company, is inadmissible and not to be considered in this proceeding by reason of the previous adjudication in favor of the plaintiff.

PLAINTIFF'S 5TH PRAYER.

Plaintiff prays the Court to instruct itself that all of the evidence presented relating to the consolidation as of February 15, 1917, and the evidence relating to any dif-
(28) ferences between The Western Maryland Railway Company and Western Maryland Railway Company, is inadmissible and not to be considered in this proceeding by reason of the previous adjudication in favor of the plaintiff.

(29) **VERDICT AND JUDGMENT.**

Whereupon, the issues joined as aforesaid between the parties aforesaid were tried before the Court without a Jury upon a stipulation of facts agreed upon by counsel, and the Court having considered same, doth find for the plaintiff and assess the damages of said plaintiff to the sum of Fifty Six Thousand Five Hundred Fifty Seven Dollars and thirty six cents, with interest as provided by the Statute, Sec. 177 of the Judicial Code as amended.

JUDGMENT.

Therefore it is considered by the Court here that the said plaintiff recover against the said defendant as well the said sum of Fifty six thousand five hundred fifty seven dollars and thirty six cents aforesaid, as the sum of Sixty dollars ($60.00), adjudged by the Court unto the said plaintiff for its costs and charges about its suit in its behalf expended.

MEMORANDUM.

Verdict was rendered in the above entitled case on the 20th day of October, 1931, and Judgment on the 22nd day of October, 1931.

PETITION, CONSENT AND ORDER OF COURT EXTENDING THE TIME FOR SIGNING AND FILING THE BILL OF EXCEPTIONS HEREIN SIXTY DAYS FROM 18TH NOVEMBER, 1931.

(30) Filed 18th November, 1931.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff, Galen L. Tait, Collector of Internal Revenue, Defendant.	
Western Maryland Railway Company, a corporation, Plaintiff, *vs.* The United States of America, a sovereign, Defendant.	Law Numbers 4172, 4174 and 4469.
Western Maryland Railway Company, a corporation, Plaintiff, *vs.* Galen L. Tait, Collector of Internal Revenue, Defendant.	

To the Honorable the Judge of said Court:

The petition of Galen L. Tait, Collector of Internal Revenue, by Simon E. Sobeloff, United States Attorney in and for the District of Maryland, respectfully represents:

First: That on the 20th day of October, 1931, there was entered in the above entitled cases by this Court a verdict in favor of the plaintiff in the sum of

Fifty-six Thousand, Five Hundred Fifty-seven dollars and Thirty-six Cents ($56,557.36) with interest, on which verdict there was entered a judgment *nisi*, and finally on the 22nd day of October, 1931, a judgment on the verdict absolute was entered in favor of the plaintiff, for said sum.

Second: That in order to protect the defendant's right of appeal in the above entitled cases, and according to Rule 39 of this Court, it is necessary that a (31) bill of exceptions be filed within thirty days from the entry of said judgment, to wit, on or before November 19, 1931.

Third: That it is not possible for the attorney for the defendant to prepare said bill of exceptions and fully agree as to the contents thereof with the attorney for the plaintiff on or before the said 19th day of November, 1931, according to the rule of this Court as above set forth.

Your Petitioner, therefore, prays that this Honorable Court pass its order extending the time for signing and filing the bill of exceptions in the above entitled cases for sixty days from the date of the order herein prayed.

SIMON E. SOBELOFF,
United States Attorney.

As Attorney for the Plaintiff in the above cases I have read the aforegoing petition, and do hereby consent to the extending of the time for signing and filing the bill of exceptions in the above cases for sixty days from the date of the order granting said extension.

WILLIAM C. PURNELL,
Attorney for Plaintiff.

(32) **ORDER OF COURT.**

Upon the aforegoing petition and consent it is Ordered this 18th day of November, 1931, that the time for

signing and filing the bill of exceptions in the above entitled cases be and the same is hereby extended for sixty days from the date of this order.

W. CALVIN CHESNUT,
United States District Judge.

PETITION, CONSENT AND ORDER OF COURT EXTENDING THE TIME FOR SIGNING AND FILING THE BILL OF EXCEPTIONS HEREIN FIFTEEN DAYS FROM 15TH JANUARY, 1932.

(33) Filed 15th January, 1932.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
} Law Number 4172

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
} Law Number 4174

Western Maryland Railway Company, a corporation, Plaintiff,
vs.
Galen L. Tait, Collector of Internal Revenue, Defendant.
} Law Number 4469

To the Honorable, the Judge of said Court:

The petition of Galen L. Tait, Collector of Internal Revenue, by Simon E. Sobeloff, United States Attorney in and for the District of Maryland, respectfully represents:

First: That on the 20th day of October, 1931, there was entered in the above entitled cases by this Court a verdict in favor of the plaintiff in the sum of (34) Fifty-six Thousand, Five Hundred Fifty-seven Dollars and Thirty-six Cents ($56,557.36) with interest, on which verdict there was entered a judgment *nisi*, and finally on the 22nd day of October, 1931, a judgment on the verdict absolute was entered in favor of the plaintiff for said sum.

Second: That by order of this Honorable Court upon petition and consent it was ordered on the 19th day of November, 1931, that the time for signing and filing the bill of exceptions in the above entitled cases be extended for sixty days from the date of said order, which will expire on the 19th of January, 1932.

Third. That it is not possible for the attorney for the defendant to prepare said bill of exceptions and fully agree as to the contents thereof with the attorney for the plaintiff on or before the said 19th day of January, 1932, according to the order of this Court as above set forth.

Your petitioner, therefore, prays that this Honorable Court pass its order extending the time for signing and filing the bill of exceptions in the above entitled cases for fifteen days from the date of the order herein prayed.

SIMON E. SOBELOFF,
United States Attorney.

As attorney for the plaintiff in the above cases I have read the aforegoing petition, and do hereby consent to the extending of the time for signing and filing the bill of exceptions in the above cases for fifteen days from the date of the order granting said extension.

EUGENE S. WILLIAMS,
Attorney for Plaintiff.

(35) **ORDER OF COURT.**

Upon the aforegoing petition and consent it is Ordered this 15th day of January, 1932, that the time for signing and filing the bill of exceptions in the above entitled cases be and the same is hereby extended for fifteen days from the date of this order.

WILLIAM C. COLEMAN,
United States District Judge.

BILL OF EXCEPTIONS.

(36) Filed 30th January, 1932.

(Style of court and Title omitted.)

Be It Remembered, That heretofore, to wit, on the 28th day of May, 1931, at a stated term of said Court begun and holden in Baltimore, in and for the District of Maryland, before his Honor, William C. Coleman, District Judge, the issues joined in the above stated cause between the said parties came on to be tried before the said judge without the intervention of a jury, the parties aforesaid by their counsel having, according to the statute in such case made and provided, waived a jury; the (37) plaintiff being represented by Eugene S. Williams, its attorney, and the defendants by Simon E. Sobeloff, his attorney.

It was stipulated and agreed by and between the parties hereto, by their respective counsel of record, that the following facts may be taken as true and so considered by the Court in the determination of the above styled causes, subject, however, to the right of either party to object to the admissibility of all or any part of the facts hereinafter stipulated upon the ground of irrelevancy and/or immateriality.

(1) The foregoing causes may be consolidated for hearing.

(2) The plaintiff abandons the Sixth and Seventh Counts of the original declaration in Law Number 4172.

(3) Plaintiff, Western Maryland Railway Company, has outstanding as its main obligation, which it assumed as hereinafter outlined, First Mortgage 4 Per cent Bonds in the aggregate amount of Forty-six Million Six Hundred Thirty-three Thousand ($46,633,000) Dollars. $42,518,000 of said bonds were credited and issued at a discount of $3,021,351.67 over the period from October, 1902, to December, 1908, by Western Maryland Rail Road Company, a corporation of the State of Maryland, and secured by a first mortgage on its property dated October 1, 1902.

The total authorized issue of said First Mortgage 4 Per cent Bonds, under the mortgage securing same, was Fifty Million Dollars and *The* Western Maryland *Railway* Company, successor to the said Western Maryland Rail Road Company as hereinafter set forth, in July and August, 1911, issued and sold, in addition to the Forty-two Million Five Hundred Eighteen Thousand ($42,518,000) Dollars of said bonds already outstanding, Four Million One Hundred Fifteen Thousand ($4,115,000) Dollars of said bonds at a total discount of Six Hun-
(38) dred Seventeen Thousand One Hundred ($617,100) Dollars, which bonds were issued in the name of Western Maryland Rail Road Company and were identical in every way with the bonds of the same series which had previously been sold by Western Maryland Rail Road Company as aforesaid, and which were secured by the same mortgage dated October 1, 1902.

On March 5, 1908, a receiver was appointed for Western Maryland Rail Road Company and its entire property was sold under Court proceedings brought to foreclose a second mortgage securing certain second mortgage bonds of said company. The property was purchased by a reorganization committee representing the holders of said second mortgage bonds, which property was thereafter sold and conveyed to *The* Western Maryland *Railway* Company, a new corporation created under the laws of the State of Maryland, for the purpose of acquiring and operating said property, and with charter provisions substantially the same as those of the old company, except as to the amount of authorized capital stock hereinafter mentioned. As a part of the purchase price of said property, which was taken subject to

the mortgage lien securing the payment of the said First Mortgage 4 Per cent Bonds here involved, *The* Western Maryland *Railway* Company assumed the obligation of said First Mortgage 4 Per cent Bonds and interest, and began the operation of the property on January 1, 1910.

In setting up its accounts as of that date it entered upon its books as a liability the face amount of said bonds, but did not record thereon the above-mentioned discount of $3,021,351.67 as such. Neither Western Maryland Railroad Company nor *The* Western Maryland *Railway* Company amortized said discount upon its books.

The above-mentioned discounts of $3,021,351.67 and $617,100.00, aggregating $3,638,451.67, represent the amount here sought to be amortized and deducted from gross income for the years in question.

(39) The aliquot portion of said discount of $3,021,-351.67 applicable to each of the years 1920, 1921, 1922, 1923, 1924, and 1925, if amortized, is $65,801.16 and the aliquot portion of said discount of $617,100.00 applicable to each of said years 1920, 1921, 1922, 1923, 1924, and 1925, if amortized, is $14,995.08.

Western Maryland Rail Road Company had outstanding at the time of the sale above referred to, in addition to the First Mortgage 4 Per cent Bonds, Ten Million ($10,000,000) Dollars of second mortgage bonds and Fifteen Million Six Hundred Eighty-five Thousand Four Hundred ($15,685,400) Dollars of capital stock with charter power to increase the amount thereof. The new company, *The* Western Maryland *Railway* Company, had an authorized capital stock issue of Fifty-Million ($50,000,000) Dollars common and Ten Million ($10,000,-000) Dollars preferred. Holders of the second mortgage bonds received the Ten Million ($10,000,000) Dollars preferred stock, and, in addition, Eight Hundred Thirty-six Thousand ($836,000) Dollars par value of common stock of the said new company in payment of overdue interest coupons on said second mortgage bonds. These bondholders were also permitted to purchase and did purchase Five Million ($5,000,000) Dollars par value of common stock upon payment of forty per cent thereof. The holders of the old capital stock upon payment of forty per cent of its par value, received in exchange share for share the new common stock to the extent of

the outstanding Fifteen Million Six Hundred Eighty-five Thousand Four Hundred ($15,685,400) Dollars.

Officers of the old company became officers of the new, and directors of the new company were, in part, the same as the directors of the old company.

The Western Maryland *Railway* Company operated the property from January 1, 1910, to February 15, 1917, when it was consolidated with its subsidiary companies and the property conveyed to its successor corporation, Western Maryland Railway Company, plaintiff (40) herein, in accordance with a certain agreement of consolidation dated January 23, 1917, a copy of which is attached hereto as a part hereof marked Exhibit A.

The consolidation was effected under Chapter 553 of the Acts of 1890 of the General Assembly of Maryland, as amended by Chapter 664 of the Acts of 1916, being Article 23, Section 218 of Bagby's Annotated Code of Maryland and in conformity with the Act of March 24, 1865, P. L. 49 and the Act of April 10, 1869, P. L. 24 of the Statute of Pennsylvania.

The plaintiff issued three classes of stock, to wit, first preferred in the amount of Seventeen Million Seven Hundred Sixty Thousand and Four Hundred ($17,760,400) Dollars, second preferred in the amount of Ten Million ($10,000,000) Dollars, and common in the amount of Fifty Million ($50,000,000) Dollars.

All clases of stock of the three companies here involved were of the par value of One Hundred ($100) Dollars per share and each share, both common and preferred, carried the right to one vote at all stockholders' meetings. The rights and preferences of the respective classes of stock of the plaintiff were and are as outlined at Article 7 (page 14) of Exhibit A attached hereto The preferred stock of *The* Western Maryland *Railway* Company was preferred as to dividends and in liquidating distributions of assets.

The common stock of *The* Western Maryland *Railway* Company was exchanged, share for share, for the common stock of the plaintiff. The preferred stock of *The* Western Maryland *Railway* Company was exchanged, share for share, for the second preferred stock of the plaintiff.

Except as set forth, *infra*, the first preferred stock of the plaintiff was issued to the holders of certain se-

cured promissory notes of *The* Western Maryland *Railway* Company which matured in 1915, and which, with accrued interest, equaled the amount of the first preferred stock which was issued. The stockholders of *The* (41) Western Maryland *Railway* Company were given the privilege of purchasing the first preferred stock of the consolidated company at par in the proportion of their respective holdings of the stock of *The* Western Maryland *Railway* Company. Substantially less than the majority of said stock was acquired under said privilege and the amount received from such sales was applied in payment of the debt evidenced by said notes. The balance of said first preferred stock was accepted at par by the noteholders in payment and in discharge of the notes and interest.

All of the subsidiary companies, mentioned on page 1 of the Exhibit A, were planned and organized by Western Maryland Rail Road Company as a convenient method of financing the construction of certain extensions of its line of railroad which were made from time to time. All of the capital stock of the respective subsidiaries was immediately issued to the said Rail Road Company, and a perpetual lease taken by the latter upon the properties of the former. The foregoing is to be modified only with respect to Baltimore and Harrisburg Railway Company, to the extent that that company had been in operation prior to the time that it was acquired as one of the subsidiary companies. Its capital stock was acquired, a perpetual lease taken upon its property, and the operation of its line merged with that of the Western Maryland Rail Road Company in the same manner as was done with reference to the other subsidiaries.

In the acquisition of the properties of the Western Maryland Rail Road Company by *The* Western Maryland *Railway* Company, as above set forth, the said *The* Western Maryland *Railway* Company acquired the stock of said subsidiaries and the aforesaid leases.

The operation of the properties of the subsidiaries by each parent company with its own line as a single system, under the leases above referred to, dates from 1881, in the case of the oldest lease, and from 1896, (42) in the case of the most recent lease.

None of the subsidiaries ever operated any of the properties to which they held title, or otherwise engaged

in carrying on business (except the Baltimore and Harrisburg Railway Company prior to the time it was acquired as hereinbefore explained). No separate books of account were kept, nor tariffs published by any of the subsidiaries, but *The* Western Maryland *Railway* Company and its predecessor, Western Maryland Rail Road Company, operated their own properties and those of the subsidiaries as a single system, under the name of *The* Western Maryland *Railway* Company or of Western Maryland Rail Road Company prior to January 1, 1910, and so reported annually to the Interstate Commerce Commission. The tariff publications of both companies applied to each respectively and their subsidiaries as a unit, and the names of the subsidiaries did not appear in the tariffs. Such tariff publications were on file with the Interstate Commerce Commission in compliance with an Act of Congress known as the Interstate Commerce Act, and with the Public Service Commissions of the State of Maryland, Pennsylvania and West Virginia, within which states the railroad system operated, in pursuance of the statutory requirements of those states. When the plaintiff took over the operation of the properties in 1917 and when *The* Western Maryland *Railway* Company took over the operation of the properties in 1910, these tariffs were not cancelled, but remained under the name of the latter company and/or of Western Maryland Rail Road Company and were applied just as they had been prior to the consolidation or the 1910 reorganization.

All taxes, federal, state and local, upon the properties of the subsidiaries prior to 1910 were paid by Western Maryland Rail Road Company and by *The* Western Maryland *Railway* Company, prior to 1917, in accordance with the requirements of the terms of the leases.

The officers and directors of *The* Western Maryland *Railway* Company, and prior to 1910, of the Western Maryland Rail Road Company, were also the officers and (43) directors of the subsidiary corporations. And the officers and the directors of *The* Western Maryland *Railway* Company became the officers and directors of the plaintiff.

The bonds of such of the subsidiaries as had issued bonds, remained outstanding after 1910 all of which were recognized and treated by *The* Western Maryland *Rail-*

way Company on its books as its own obligations. Such of said bonds as had not been retired prior to the consolidation of 1917 remained outstanding after 1917 and were recognized by the plaintiff on its books as its own obligations.

All of the above-mentioned companies were common carriers subject to the rules and regulations of the Interstate Commerce Commission and kept their books of accounts upon the accrual basis as required by said Interstate Commerce Commission.

No part of the above-mentioned discounts of $3,021,351.67 and $617,100.00 was brought forward as such or amortized on the books of the plaintiff or amortized in its reports to the Interstate Commerce Commission.

The Interstate Commerce Commission's Classification of Income, Profit and Loss, and General Balance Sheet Accounts for Steam Roads, Issue of 1914, Effective on July 1, 1914, is attached hereto and made a part hereof as Exhibit B.

Attached hereto and made a part hereof as Exhibit C are copies of communications with respect to Plaintiff's accounts received by the plaintiff from Alexander Wylie, Director of the Bureau of Accounts of the Interstate Commerce Commission.

(4) For the year 1920 the plaintiff duly filed its income and profits tax return showing a tax liability of $4,259.28 which was paid in four equal installments of $1,064.82 on March 15, June 18, October 11, and Decem-
(44) ber 13, 1921; that the first two of said installments were paid to former Collector of Internal Revenue, Joshua W. Miles, and that the balance of said tax was paid to the defendant, Galen L. Tait, Collector of Internal Revenue; that on January 6, 1925 the plaintiff filed a claim for credit in the amount of $8,079.60, based upon the contention that in its said return the plaintiff failed to deduct from income an item of $80,796.24, being the annual aliquot portion of the above-mentioned bond discounts; that said claim for credit was rejected by the Commissioner of Internal Revenues; that on February 11, 1928 an additional tax of $88,417.89, together with interest amounting to $10,400.61, was assessed by the Commissioner of Internal Revenue, which was discharged

by the application of a credit in the amount of $34,470.99 and the payment on March 21, 1928 of the balance thereof.

(5) For the year 1921 the plaintiff duly filed its income and profits tax return showing a tax liability of $51,148.05, which was paid in four equal installments on April 15, June 21, September 15, and December 15, 1922; that on January 6, 1925 a claim for credit in the amount of $8,079.60 was filed, based upon the contention that the plaintiff failed to deduct from income in its said return the annual aliquot portions of said bond discounts amounting to $80,796.24; that said claim for credit was rejected by the Commissioner of Internal Revenue.

(6) For the year 1922 the plaintiff duly filed its income tax return showing a tax liability of $11,168.43 which was duly paid in four equal installments on March 15, June 16, September 24, and December 15, 1923; that on January 6, 1925 a claim for credit was filed based on the contention that the plaintiff failed to deduct from income in said return the annual aliquot portions of said bond discounts amounting to $80,796.24; that said claim for credit was rejected by the Commissioner of Internal Revenue.

(7) For the year 1923 the plaintiff duly filed its income tax return showing a tax liability of $181,657.04 (45) which was paid in four equal installments of $45,414.26 on March 15, June 14, September 15, and December 15, 1924; that on October 11, 1930, an additional tax of $45,758.60, together with interest amounting to $16,524.18, was assessed against the plaintiff by the Commissioner of Internal Revenue, which was discharged by the application of over-assessments for the years 1924 and 1925 on October 23, 1930, and by the payment of $11,554.97 on December 5, 1930; that in making said additional assessment the Commissioner of Internal Revenue disallowed as a deduction from income an item of $80,796.24, being the annual aliquot portions of the above-mentioned bond discounts; that the plaintiff duly and timely filed a claim for refund in the amount of $10,099.53 based upon the contention that the Commissioner of Internal Revenue erroneously disallowed said deduc-

tion; that said claim for refund was rejected by the Commissioner of Internal Revenue.

(8) For the year 1924 the plaintiff duly filed its income tax return showing a tax liability of $163,024.40, which was paid in four equal installments of $25,756.10 on March 16, June 16, September 18, and December 17, 1925; that in said return the plaintiff deducted from income an item of $80,796.24, being the annual aliquot portions of the above-mentioned bond discounts for the year 1924; that in his final determination of the plaintiff's tax liability for said year 1924, the Commissioner of Internal Revenue disallowed said deduction; that the plaintiff duly and timely filed claims for refund based upon the contention that the Commissioner of Internal Revenue erroneously disallowed the said deduction; that said claims for refund have been rejected by the Commissioner of Internal Revenue.

(9) For the year 1925 the plaintiff filed its income tax return showing a tax liability of $238,936.79 which was paid in installments of $57,344.83, $57,344.83, $62,123.57, and $62,123.56 on March 16, June 16, September 16 and December 16, 1926, respectively; that in said return the plaintiff deducted from gross income an item of $80,796.24, being the annual aliquot portions of the above-mentioned bond discounts applicable to said year (47) 1925; that in his final determination of the tax liability of the plaintiff the Commissioner of Internal Revenue disallowed said deduction; that plaintiff duly and timely filed claims for refund based upon the contention that the Commissioner erroneously disallowed said deduction; that the said claims for refund have been rejected by the Commissioner of Internal Revenue.

(10) In the determination of the plaintiff's taxable net income for the said years 1920, 1921, 1922, 1923, 1924, and 1925, the Commissioner of Internal Revenue did not allow as a deduction from plaintiff's income any part of said bond discount.

Thereupon the defendants submitted to the Court a request for conclusions of law on the 28th day of May, 1931, as follows:

"It is requested that the Court find and return as a conclusion of law that the plaintiff, in the determination of his (its) tax liability for the years in question, is not entitled to authorize and deduct from income for said years any portion of the bond discount herein involved."

Thereupon the defendants submitted to the Court a request for special finding of facts on the 28th day of May, 1931, as follows:

"It is requested that the Court make and return in the above mentioned cases special finding of facts in the manner of and as set forth in the stipulation of facts filed herein."

Thereupon the defendant submitted to the Court a motion for judgment in favor of the defendants on the 28th day of May, 1931, as follows:

"The defendants herein, and each of them, move the Court for judgment in favor of the defendants."

Thereupon, the evidence being closed, the Court rendered its opinion which was transcribed and filed in the (47) record of the case in the Clerk's office on the 20th day of October, 1931, as follows:

"These are three suits brought by the Western Maryland Railway Company to recover the sum of $56,557.36 in income taxes, for the six calendar years 1920 to 1925, inclusive, which it claims were erroneously and unlawfully assessed against and collected from it. The precise question involved is whether the railway company had the right to deduct, in its income tax returns for each of these years, an amortized portion of the bond discount arising from the sale of bonds by its two predecessors in ownership of the property against which the bonds were issued.

"The cases having been consolidated, were heard together, by the Court, upon a lengthy stipulation of facts, which narrates the complete details of two reorganizations of the railroad, one in 1908-1910, the other in 1917. Suffice it to summarize the material facts necessary to a

proper understanding of the present controversy, as follows. On October 1, 1902, a first mortgage, authorizing a $50,000,000 bond issue, was placed upon the properties of the Western Maryland Rail Road Company. Bonds to the extent of $42,518,000, maturing in 1952, were sold under this mortgage from year to year, at a total discount of $3,021,351.67 until 1908, when a $10,000,000 second mortgage on the railroad's property became in default; a receiver was appointed; the property was sold under foreclosure proceedings in the United States Circuit Court for the District of Maryland, and was purchased by a reorganization committee. A new company known as The Western Maryland Railway Company, was formed, which took over the property from the reorganization committee, and began operating the same lines of railroad on January 1, 1910. As of this date, it set up the face amount of the bonds already outstanding as a charge to the cost of property. No separate entry was made of the discount.

"The Railway Company issued $10,000,000 of preferred stock to the holders of the second (foreclosed) mortgage bonds, and an additional amount of common stock to cover their unpaid interest coupons. $50,000,000 of common stock was issued, and upon payment of $40 per share by way of assessment, the holders of the old common stock were entitled to a share for share exchange for the new common stock. The controlling stock interests remained the same, and there were only slight changes in the management of the railroad. The first mortgage of 1902 remained a first mortgage on the property in the hands of The Western Maryland Railway Company, and in 1910 and 1911, $4,115,000 additional first mortgage bonds, still bearing the name of Western (48) Maryland Rail Road Company, were sold by the Railway Company. A further discount of $617,100 was incurred in this sale of bonds. None were sold thereafter.

"In 1915 and 1916 The Western Maryland Railway Company defaulted in interest upon certain secured promissory notes, and in 1917 a new corporation, which is the present plaintiff, Western Maryland Railway Company, was created by a consolidation of The Western Maryland Railway Company and seven subsidiary companies of the latter operating in both Maryland and Pennsylvania. The plaintiff issued two classes of pre-

ferred stock. Its first preferred stock discharged the lien of the defaulted promissory notes, and the second preferred stock took the place of the preferred stock of The Western Maryland Railway Company. The common stock was exchanged, share or share, for that of The Western Railway Company without assessment. No change whatever took place in the management, and the old mortgage of 1902, with the bonds sold under it, remained a first lien on the property in the hands of the plaintiff.

"The plaintiff made a contention, similar to the one now presented, before the Board of Tax Appeals with respect to its income tax returns for the year 1918 and 1919. The Board refused to permit the deduction, basing its denial primarily upon the fact that a new corporation had been created as a result of the consolidation that took place in 1917, and that the new corporation, in taking over the property and assuming the debts of the old one, had paid no discount on the bonds, and consequently was not entitled to amortize discount. However, the Circuit Court of Appeals, on petition to review, reversed this decision of the Board of Tax Appeals, 33 F. (2d) 695. Plaintiff contends that this decision of the appellate court is *res adjudicata* of the present controversy for the following reasons: (1) the present suit involves the same discount upon the same bonds as did the former litigation, except for different years, which is immaterial in the application of the principle of *res adjudicata;* (2) the same Revenue Act involved in the former suit, namely, that of 1918, is applicable to the year 1920, here involved; and the Acts of 1921 and 1924, which govern the remaining years here involved, are identical, on the question of amortization of discount, with the Act of 1918.

"The Government does not deny the correctness of these two premises. Indeed they are not controvertible. See *City of New Orleans* vs. *Citizens Bank of Louisiana*, 167 U. S. 371. But the Government does deny that the facts, as stipulated in the present suits, justify a conclusion that it is precluded by what the Circuit Court of Appeals decided in the former case, because, as the (49) Government asserts, the issue here presented is different. In other words, it contends that the evidence submitted to the Board of Tax Appeals and to the Circuit

Court of Appeals did not disclose that the bonds in question were issued by a corporation whose assets were sold, in a receivership proceeding, to a new corporation, the stockholders of which differed to a material extent from the stockholders of the insolvent corporation; that the case before the Circuit Court of Appeals presented the question of law as to whether or not a corporation, which acquired assets through the merging of several other corporations, is entitled to amortize discount arising from the issue of bonds by one or more of the merging corporations, whereas in the present proceeding the principal question to be decided is whether or not the purchaser of property at a receiver's sale is entitled to amortize discount on bonds issued by the insolvent when the purchaser assumes liability under such bonds, as part of the purchase price of the assets,—a question which the Government contends, was not before the Circuit Court of Appeals in the earlier case. The Government admits that in the present proceeding, in so far as it relates to bonds with a face value of $4,115,000.00 issued by The Western Maryland Railway Company, which for convenience we may properly call Company No. 2, at a discount of $617,100.00, the question is the same as that presented in the earlier case; but not as to bonds with a face value of $42,518,000.00 issued at a discount of $3,021,351.67, by the Western Maryland Railroad Company, for convenience called Company No. 1, which subsequently became insolvent.

"An examination of the record before the Circuit Court of Appeals in the earlier case, and the ratio *decidendi* of that Court's opinion, convinces us that the Government's contention is untenable. It is true that in the former litigation, the 1917 change of corporate structure, and not the change of 1908-1910, was the one which was stressed, and therefore the one primarily in issue. But the earlier reorganization was before the Board of Tax Appeals and the appellate court in the stipulation of facts and in the pleadings. This is confirmed by the following statement in the opinion of the Circuit Court of Appeals, (page 696), in which it is true it consolidates the bond issue of the first company, the Western Maryland Rail Road Company of the total face value of $42,518,000 with the bond issue of the second company, The Western Maryland Railway Company (the immediate

predecessor of the present plaintiff), of the total face value of $4,115,000, and a grand total of $46,633,000; and similarly, consolidates the items of discounts; but the two reorganizations were of necessity before the Court: 'The facts as to the bonded indebtedness and the discount are that between April, 1904, and August, 1911, the corporation which was the predecessor of the petitioner, the Western Maryland Railway Company, issued and sold $46,633,000 of first mortgage 4 per cent bonds, (50) dated October 1, 1902, and maturing October 1, 1952, at a discount of $3,638,451.67. This discount was set up on the books of the company as of January 1, 1910, and the annual proportion thereof, amounting to $80,796.24, was charged off each year thereafter.'

"After stating (page 698) that 'the consolidated corporation has stepped into the place of the corporation which issued the bonds, and occupies the same relationship towards them that it occupied', the court continued, pages 698-699: 'In the second place, we think that, irrespective of the practical identity of the old and new corporations, petitioner is entitled to the deduction claimed because of having taken over the assets and assumed the liabilities of the old corporation which was unquestionably entitled to it. Among the liabilities of the old corporation as shown by its books was the bond issue; and among its assets was the amount set up as bond discount, against which was charged each year an amortized portion thereof. In taking over the liabilities and assets, the new corporation took the place of the old as to both of those items. As has been said, bond discount is really deferred interest payable at the maturity of the bonds. When, therefore, the new corporation assumed the obligations of the old, its agreement to pay the bonds at maturity embraced necessarily the agreement to pay this deferred interest, which is included in the face of the bonds. As the new corporation is bound to pay this, there is no reason why it should not amortize it in the same way as the old corporation.

"'It is argued, however, that the new corporation has agreed to pay the full face of the bonds in consideration of the assets transferred to it, and that, for this reason, it has received full consideration for them and has suffered no discount. But this by no means follows.

The fact that bonds have been sold at a discount presupposes that the interest rate which they carry is less than the prevailing rate at the time of sale; and it is but fair to assume that this has been taken into account in the price paid or the terms agreed upon for the transfer of the corporate assets. The matter takes care of itself in the case of a reorganization such as this; for it is manifest that, as the discount was mirrored in the affairs of the old corporation by the fact that its actual assets were that much less than they would have been had the discount not been exacted, it is mirrored in exactly the same way when the assets pass into the hands of the reorganization. As a man cannot lift himself by his own bootstraps, so a corporation cannot, by a mere process of reorganization, increase its actual assets or wipe out the fact that it is bound to pay bond discount which is in reality deferred interest.'

"If the aforegoing reasoning is to be given proper interpretation, it must be taken as being just as applicable to a plurality, or series of consolidations, as it is (51) to a single one, provided the same essential elements are always successively present, namely, acquisition by the successor corporation of the particular assets and liabilities of its predecessor. If these do exist, then the precise manner of acquisition is not, as the Government contends, material. Company No. 1 was sold to Company No. 2 under foreclosure proceedings, whereas Company No. 2 was merged into Company No. 3 by a consolidation of itself and seven of its subsidiary companies. But the original mortgage under which all the bonds here involved had been issued, still remains a first lien on the original property, now in the hands of the plaintiff, just as it had been when the property was in the hands of the plaintiff's two predecessors.

"Thus we must conclude that further litigation of the question here raised is precluded by the decision of the Circuit Court of Appeals, because the same material facts were before that Court. In its last analysis the Government's contention but comes to this: either that the available grounds for argument against plaintiff's contention were not made the dominant issue in the previous litigation, or that the Government is now seeking to obtain, through this Court, a modification of the appellate court's ruling which, of course, may only be sought by

a petition for rehearing, or for a writ of certiorari to the Supreme Court, seasonably made, neither of which has been done. As was said in *Grubb* vs. *Public Utilities Commission*, 281 U. S. 470, at 478-9: 'The thing presented for adjudication in the case in the state court was the validity of the order, and it was incumbent on the appellant to present in support of his asserted right of attack every available ground of which he had knowledge. He was not at liberty to prosecute that right by piecemeal, as by presenting a part only of the available grounds and reserving others for another suit, if failing in that. *Worlein* v. *New Orleans*, 177 U. S. 390, 398, *et seq.*; *United States* v. *California and Oregon Land Co.*, 192 U. S. 355, 358.

"'As the ground just described was available but not put forward the appellant must abide by the rule that a judgment upon the merits in one suit is *res adjudicata* in another where the parties and subject matter are the same, not only as respects matters actually presented to sustain or defeat the right asserted, but also as respects any other available matter which might have been presented to that end. *Baltimore S. S. Co.* v. *Phillips*, 274 U. S. 316, 319; *United States* v. *Moser*, 266 U. S. 236, 241; *Cromwell* v. *County of Sac*, 94 U. S. 351, 352.' See also, *Southern Pacific R. Co.* vs. *U. S.* 168 U. S. 1.

"The identity of the amortization of discount provision in the revenue acts here involved, with the corresponding provision in the Act of 1918, has already been alluded to. Therefore, since the Circuit Court of Appeals has held the deduction permissible under the one, (52) we must hold likewise under the others.

"Finally, in answer to the argument that the appellate court proceeded upon the mistaken assumption that the plaintiff had actually set up upon its books the amortization of the discount, it is enough to say, (1) that such a mistake of fact, regardless of its materiality, may not now be attacked. *Vinson* vs. *Graham*, 44 F. (2d) 772; and that (2) bookkeeping entries cannot be permitted to control over the actual facts. *Doyle* vs. *Mitchell Brothers Co.*, 247 U. S. 179. And so the Board of Tax Appeals has itself repeatedly held. *C. R. I. & Pac. Ry. Co.* vs. *Commisisoner*, 13 B.T. A. 988; *Kansas City So. Rwy. Co.* vs. *Commissioner*, 16 B. T. A. 665; *Terminal*

Railroad Association of St. Louis vs. *Commissioner*, 17 B. T. A. 1135.

"Accordingly, the verdict must be for the plaintiff in the sum of $56,557.36, together with interest at the rate of 6% per annum on each of the respective payments which comprise said total amount, from the respective date of its payment or collection for such a period as is provided in Section 177 of the Judicial Code as amended (28 U. S. C. A. Sec. 284)."

To the action of the Court in its finding of facts, conclusions of law and judgment for the plaintiff, as set forth in said opinion to the Court, the defendant excepts and prays the Court to sign and seal this, its first Bill of Exceptions, which is accordingly done this 29th day of January, 1932.

WILLIAM C. COLEMAN (Seal)
United States District Judge.

Approved:

EUGENE S. WILLIAMS,
Attorney for Plaintiff.
SIMON E. SOBELOFF,
United States Attorney,
Attorney for Defendant.

ASSIGNMENT OF ERRORS.

(53) Filed 15th January, 1932.

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

(Style of court and Title omitted.)

And now comes Galen L. Tait, Collector of Internal Revenue, defendant in the above entitled cases, by his attorney, Simon E. Sobeloff, United States Attorney in and for the District of Maryland, and makes and files the following assignment of errors, and says that the judgment entered in these actions on the 20th day

of October, 1931, is in error and unjust for the following reasons:

(54) First: That the United States District Court for the District of Maryland erred in refusing to grant the defendant's motion for judgment in favor of the defendant.

Second: That said Court erred in finding a judgment for the plaintiff in the amount of Fifty-six Thousand, Five Hundred Fifty-seven Dollars and Thirty-six Cents ($56,557.36).

Third: That said Court erred in refusing to grant the request of the defendant for the conclusion of law that the plaintiff, in the determination of its tax liability for the years in question, is not entitled to authorize and deduct from income for said years any portion of the bond discount herein involved.

Fourth: That said Court erred in refusing to grant the request of the defendant for special finding of facts in the manner of and as set forth in the stipulation of facts filed herein.

Wherefore, defendant prays that the said judgment of the United States District Court for the District of Maryland be reversed, and the cause remanded with instructions to reverse said judgment and to enter judgment for defendant, and for such other and further relief as may be proper in the premises.

SIMON E. SOBELOFF,
United States Attorney.

STIPULATION OF COUNSEL AS TO MAKING UP RECORD ON APPEAL.

(55) Filed 8th July, 1932.

(Style of court and Title omitted.)

It is hereby stipulated that the record in this case

shall be printed in accordance with Rule 23 of the Circuit Court of Appeals for the Fourth Circuit and that there shall be included in the record to be certified and transmitted to the Clerk of that Court and to be printed by him the following documents:

1. Amended declaration in Law Number 4172.

2. Pleas to amended declaration in Law Number 4172.

(56) 3. Declaration in Law Number 4174.

4. Pleas to declaration in Law Number 4174.

5. Petition in Law Number 4177.

6. Amended declaration in Law Number 4469.

7. Pleas to amended declaration in Law Number 4469.

8. Stipulation waiving jury trial.

9. Petition of Plaintiff and Order of Court consolidating cases 4172 and 4174 with 4469.

10. Petition, assent and Order of Court consolidating Law Number 4177 with 4172, 4174 and 4469.

11. Verdict and judgment.

12. Order of Court extending time for signing and filing bill of exceptions.

13. Bill of exceptions, including opinion of Court.

14. Plaintiff's prayers.

15. Assignment of errors.

16. This stipulation.

17. It is further stipulated and agreed that the

Clerk need not incorporate the exhibits A, B, C and D, referred to in the stipulation of facts (included in the bill of exceptions), but in lieu thereof that the originals of said exhibits be transmitted to the Appellate Court for use in argument by either side.

SIMON E. SOBELOFF,
United States Attorney,
Attorney for Defendants-Appellants.
EUGENE S. WILLIAMS,
Attorney for Plaintiff-Appellee.

Approved by:

WILLIAM C. COLEMAN,
United States District Judge.

MEMORANDUM OF THE CLERK.

(57) (1) Petition for Appeal, filed 15th January, 1932.

(2) Appeal granted, 15th January, 1932.

(3) Citation dated 16th January, 1932. (Service acknowledged 25th January, 1932.)

ORDER TO TRANSMIT RECORD.

And, thereupon, it is ordered by the Court here that a transcript of the record and proceedings of the causes aforesaid, together with all things thereunto relating, be transmitted to the said United States Circuit Court of Appeals for the Fourth Circuit, and the same is transmitted accordingly.

Teste:

ARTHUR L. SPAMER, Clerk.

CLERK'S CERTIFICATE.

UNITED STATES OF AMERICA,
District of Maryland, to-wit:

I, Arthur L. Spamer, Clerk of the District Court of the United States for the District of Maryland, do hereby certify that the aforegoing is a true transcript of the record and proceedings of the said District Court together with all things thereunto relating, in the therein entitled causes, made up in accordance with stipulation of counsel for the respective parties filed in said cause.

In Testimony Whereof I hereunto set my hand and affix the seal of said District Court this 14th day of July, 1932.

(Seal of Court) ARTHUR L. SPAMER, Clerk.

Richmond Press, Inc.,
Richmond, Va.
7-18-32—65.
Contract No. J-8880.

PROCEEDINGS IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 3367

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, APPELLANT

versus

WESTERN MARYLAND RAILWAY COMPANY, APPELLEE

APPEAL from the District Court of the United States for the District of Maryland, at Baltimore. At law

July 15, 1932, the transcript of record is filed and the cause docketed.

Same day, the original petition for appeal, order allowing appeal, and citation are certified up under sec. 7 of rule 14.

Same day, petition of appellant, consented to by counsel for appellee, for extension of time, and order thereon dated May 20, 1932, signed by Senior Circuit Judge Parker, extending the time to June 15, 1932, for the filing of the transcript of record, filed.

Same day, petition of appellant, consented to by counsel for appellee, for extension of time, and order thereon dated June 10, 1932, signed by Senior Circuit Judge Parker, extending the time to July 15, 1932, for the filing of the transcript of record, filed.

Same day, the appearance of Simon E. Sobeloff, U. S. attorney, and Charles G. Page, assistant U. S. attorney, is entered for the appellant.

Same day, originals of plaintiff's Exhibits A, B, C, and D are certified up.

July 30, 1932, the appearance of Eugene S. Williams is entered for the appellee.

September 12, 1932, twenty-five copies of the printed record are filed.

September 16, 1932, stipulation as to the time for the filing of the respective briefs is filed.

Argument of cause

October 21, 1932 (October term, 1932), cause came on to be heard before Parker, Northcott, and Soper, circuit judges, and is argued by counsel and submitted.

Opinion

Filed January 10, 1933

United States Circuit Court of Appeals, Fourth Circuit

No. 3367

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, APPELLANT

versus

WESTERN MARYLAND RAILWAY COMPANY, APPELLEE

APPEAL from the District Court of the United States for the District of Maryland, at Baltimore

Argued October 21, 1932. Decided January 10, 1933

Before PARKER, NORTHCOTT, and SOPER, Circuit Judges

Charles G. Page, assistant U. S. attorney, and Simon E. Sobeloff, U. S. attorney (G. A. Youngquist, Assistant Attorney General, Sewall Key and J. Louis Monarch, special assistants to the Attorney General, on brief) for appellant, and Eugene S. Williams for appellee.

SOPER, Circuit Judge:

This case renews the controversy that was before this court in Western Maryland Railway Company vs. Commissioner of Internal Revenue, 33 F. (2d) 695, upon a petition to review a decision of the Board of Tax Appeals with regard to the income-tax liability of the Railway Company for the years 1918 and 1919. The board had denied the right of the Railway Company to deduct from its gross income for these years an amortized portion of a discount of $3,638,451.67, at which bonds in the amount of $46,633,000, that the Railway Company was bound to pay, had been previously sold. Two questions were presented in that case, as an examination of the decision of this court and the decision of the board, 12 B. T. A. 889, will disclose. They were (1) whether the discount on bonds sold by a corporation below par may be amortized for income-tax purposes over the life of the bonds by deducting a proportionate part of the discount each year as accrued interest from the gross income; and (2) whether Western Maryland Railway Company, a corporation formed under the laws of Maryland by the consolidation of a predecessor corporation and seven subsidiary corporations fully owned by it, was entitled to amortize the discount on bonds which had been issued before it came into existence, and which it had undertaken to pay. Both questions were decided in favor of the Railway Company and the decision of the Board of Tax Appeal was reversed.

The Board of Tax Appeals had held that whatever rights the Railway Company derived from the consolidation with its subsidiary

companies neither it nor its predecessor was entitled to deduct from gross income an amortized proportion of the discount. When the case was argued in this court, the commissioner did not rely on this point for the reason that in the meantime the board had held to the opposite effect in Chicago, R. I. & P. R. Co. vs. Commissioner (13 B. T. A. 988). Hence it was not denied that the Railway Company had the right to amortize the discount on the bonds if it succeeded to this right in the corporate reorganization, and the question discussed was whether the new corporation was so distinct and separate an entity that it did not acquire the right which its predecessor might have enjoyed. A decision on the propriety of amortization of discount, however, was necessary to the determination of the controversy, and it was discussed at some length in our former opinion in the light of regulations 45 of the Treasury Department, article 554, and of the decisions of the courts.

The pending case involves the same points with respect to the income tax of the railway company for the years 1920 to 1925. A suit was brought by the Railway Company against the collector of internal revenue of the United States for the district of Maryland in three counts, claiming refunds in the aggregate sum of $26,258.77, paid by the taxpayer for the years 1920 to 1922, through error in failing to amortize the discount in these years; and a separate suit against the collector for the aggregate sum of $30,298.59 paid for the years 1923 to 1925 under duress, after a deduction for the amortized discount made by the taxpayer in his income-tax return for each of said years had been disallowed by the Commissioner of Internal Revenue. There were also two other suits brought by the Railway Company against the United States, each of which was limited to the year 1920 and covered as to that year precisely the same claim as the first count of the first suit above described. All of the cases were consolidated by order of the District Court, and the matter being tried before the court without a jury upon a stipulation of facts a veriet was found for the sum of $56,557.36, the full amount of the plaintiff's claim. An appeal was taken from the refusal of the district judge to rule that under the stipulated facts the plaintiff was not entitled to recover.

We are asked to review our decision in the former litigation because of the later decision of the Supreme Court in Old Colony R. R. Co. vs. Commissioner, 284 U. S. 552. The Supreme Court held that a premium on bonds received by a corporation prior to the adoption of the sixteenth amendment was income for the year in which it was received, and no part of it may be taxed by a subsequent income tax act; and that in so far as such a premium is concerned, Treasury regulations were ineffective which provided that if bonds are issued at a premium the net amount is income which should be amortized over the life of the bonds. The approval by Congress, implied from repeated reenactments, of the interpretation of the

income-tax statutes embodied in these regulations, was held to be of no avail since the premium received had become principal prior to the sixteenth amendment and could not be reached by subsequent legislation. The case now before us is not precisely the same, for although all the bonds were issued prior to the amendment, we have to do with a discount and not with a premium, and the same constitutional difficulty does not arise. It may be questioned, however, whether regulations, which purport to authorize the amortization of discount and premium alike, can reasonably be construed to apply only to discount allowed before the amendment, when it is shown that they are invalid as to premium received at that time.

A determination of this question is not necessary to a decision of this case, for, in our opinion, the right of the Railway Company to amortize the discount on the bonds was conclusively settled by the earlier decision of this court. The applicable rule is succinctly stated in Southern Pacific R. R. Co. vs. U. S., 168 U. S. 1, as follows:

"The general principle announced in numerous cases is that a right, question, or fact distinctly put in issue and directly determined by a court of competent jurisdiction as a ground of recovery, can not be disputed in a subsequent suit between the same parties or their privies; and even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established, so long as the judgment in the first suit remains unmodified."

See also United States vs. Moser, 266 U. S. 236, 241. This principle applies to cases of taxation as well as to other subjects of litigation. New Orleans vs. Citizens Bank, 167 U. S. 371; Gunter vs. Atlantic Coast Line, 200 U. S. 273; United States vs. Stone & Downer Co., 274 U. S. 225, 230.

We are told that the doctrine of res adjudicata is not applicable in this case even to the limited extent which obtains when the subsequent cause of action arises between the same parties upon a different claim or demand, because the present controversy arises upon different facts and between different parties. The difference of fact relates to the history of the corporate organizations which preceded the present taxpayer. The present record shows that the bonds in question were issued under a mortgage executed October 1, 1902, by Western Maryland Railroad Company, a Maryland corporation (company No. 1), and that during the period from October, 1902, to December, 1908, this corporation issued $42,518,000 face value of bonds at a discount of $3,021,351.67. A receiver was appointed for this company and under proceedings to foreclose a second mortgage, all of the property of the corporation was sold and conveyed to The Western Maryland Railway Company (company No. 2), a new corporation created under the laws of Maryland, which, as part of the

purchase price, assumed the obligation of the first mortgage of its predecessor. In July and August, 1911, company No. 2 sold an additional $4,115,000 of bonds secured by the first mortgage of company No. 1 at a discount of $617,100. The second company operated the property from 1910 until 1917, when it was consolidated with the seven subsidiaries, and the property was conveyed under the consolidation agreement to the present corporation, Western Maryland Railway Company, (company No. 3), subject to the first lien of the bonds sold under the mortgage of 1902.

The point is made that this court in its prior opinion did not consider the company referred to as company No. 1, but treated the case as if the bonds had been issued by company No. 2 under its own mortgage, so that the attention of the court was directed to the question as to whether the present taxpayer was entitled to the rights of the second company, without taking into account the fact that the rights of the second company were obtained from the first. This observation is substantially correct, but the treatment of the facts by the court was due to the following stipulation by the parties, adopted by the Board of Tax Appeals as a finding of fact (which we know judicially from our own records, United States vs. California Canneries, 279 U. S. 553): "These bonds were issued by Western Maryland Railroad Company (company No. 1), a corporation organized under the laws of the State of Maryland, predecessor of, and which for the purposes of this case may be taken as identical with Railway Company (company No. 2). Railway Company succeeded Western Maryland Railroad as of January 1, 1910. * * *"

The parties acted upon this assumption throughout the suit, the commissioner contending that the claim of the taxpayer must fail because it did not itself issue the bonds at a discount but only bound itself to pay them long after they were sold. This contention as we have seen did not then prevail. We are now asked to reexamine the evidence and reach a different conclusion, and the reasons given are that the evidence in the present case shows more clearly the gap between the present corporation and the one which originally issued the greater amount of the bonds; and also that this court did not fully appreciate the force of the facts in the former case which marked the difference between the present company and the one which immediately preceded it. We are not impressed by this argument, for if a question is actually and directly in issue, and is judicially passed upon and determined in a suit, a party bound by the judgment can not escape its effects by producing a new argument or new evidence in a subsequent action in support of the proposition decided against him. Southern Pacific Railroad vs. United States, 168 U. S. 1; Gunter vs. Atlantic Coast Line, 200 U. S. 273, 290; Smith vs. Town of Ontario, 4 F. 386. If the appellee in the pending case is now permitted to produce additional evidence (which, it may be said in passing, was available at the first trial) to prove the

point which was then relied on, the settled rule would be disregarded and the purpose of the doctrine of res judicata to put an end to litigation and to protect a successful litigant from a second trial of a controversy would be defeated.

Nor is there merit in the suggestion that the doctrine of res judicata does not apply because the second suit is not between the same parties as the first. In the earlier case the taxpayer was opposed by the Commissioner of Internal Revenue, and it is conceded by the appellee that the commissioner was acting in his official capacity as a representative of the United States, and that the judgment against him, if otherwise conclusive, should be given full effect in the present suits against the United States. It is urged, however, that the former judgment is not binding on the collector of internal revenue in the present suits against him for the reasons given by this court in Strother vs. Commissioner and Bankers Pocahontas Coal Company vs. Commissioner, 55 F. (2d) 626, affirmed by the Supreme Court on December 5, 1932. In these cases the decision of the Supreme Court in Sage vs. United States, 250 U. S. 33, 39, was relied on and reaffirmed to the effect that a judgment in a former suit brought by a taxpayer against a collector is not res judicata in a later suit brought by the taxpayer against the Commissioner of Internal Revenue of the United States. It was shown in Sage vs. United States that a judgment in a suit against a collector is not technically a judgment against, or in favor, of the United States: that the suit is personal and its incidents, such as the nature of the defenses open and the allowance of interest, are different; that at the time the judgment is entered, the United States is a stranger, and subsequently the discretionary action of officials may or may not give the United States a practical interest in the amount of the judgment. But it does not follow that a collector of internal revenue may not be bound by a judgment rendered in a prior suit against the United States, or the Commissioner of Internal Revenue, acting in its behalf. Taxes erroneously collected by a collector of internal revenue are received by him in his capacity as an agent of the United States, and if it has been subsequently determined by the judgment of a court that his principal was not entitled to receive them the agent is bound by the judgment and may not contest the point anew. See Second National Bank of Saginaw vs. Woodward, 54 F. (2d) 672; Bertelsen vs. White, 58 F. (2d) 792. The judgment of the District Court is affirmed.

NORTHCOTT, Circuit Judge, concurring:

I concur, for the reason that I feel myself bound by the former decision of a majority of this court in Western Maryland Railway Co. vs. Commissioner, 33 Fed. (2) 695, in which case I dissented.

Judgment

Filed and entered January 13, 1933

United States Circuit Court of Appeals, Fourth Circuit

No. 3367

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, APPELLANT
vs.
WESTERN MARYLAND RAILWAY COMPANY, APPELLEE

APPEAL from the District Court of the United States for the District of Maryland

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Maryland, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said district court, in this cause, be, and the same is hereby, affirmed.

January 13, 1933.

MORRIS A. SOPER,
U. S. Circuit Judge.

Order staying mandate

Filed February 4, 1933

(Style of court and title omitted.)

Upon the application of the appellant, by Simon E. Sobeloff, U. S. attorney, his attorney, and for good cause shown.

It is ordered that the mandate of this court in the above-entitled case be, and the same is hereby, stayed for thirty days from this date.

February 4, 1933.

JOHN J. PARKER,
Senior Circuit Judge.

Order further staying mandate

Filed March 3, 1933

(Style of court and title omitted.)

Upon the application of the appellant, by Simon E. Sobeloff, U. S. attorney, his attorney, and for good cause shown,

It is ordered that the mandate of this court in the above-entitled case be, and the same is hereby, further stayed for 30 days from this date.

March 3, 1933.

JOHN J. PARKER,
Senior Circuit Judge.

Clerk's certificate

UNITED STATES OF AMERICA,
Fourth Circuit, ss:

I, Claude M. Dean, clerk of the United States Circuit Court of Appeals for the Fourth Circuit, do certify that the foregoing is a true copy of the record and proceedings in the therein entitled cause, as the same remain upon the records and files of the said Circuit Court of Appeals.

In testimony whereof, I hereto set my hand and affix the seal of the said United States Circuit Court of Appeals for the Fourth Circuit, at Richmond, Virginia, this 16th day of March, A. D. 1933.

[SEAL.] CLAUDE M. DEAN,
Clerk U. S. Circuit Court of Appeals, Fourth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1933

Supreme Court of the United States

Order allowing certiorari

Filed April 24, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. —

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, petitioner

v.

WESTERN MARYLAND RAILWAY COMPANY, A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the Collector and of the United States, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fourth Circuit entered in the above cause on January 13, 1933.

OPINIONS BELOW

The opinion of the United States District Court for the District of Maryland (R. 38–45) is reported in 53 F. (2d) 211. The opinion of the Circuit Court of Appeals (R. 52–56) is not yet reported. 62 F. (2d) 933.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an earlier decision of the Circuit Court of Appeals for the Fourth Circuit in a proceeding involving other tax years was *res adjudicata* of the issues herein.

2. Whether the discount on bonds sold prior to March 1, 1913, by respondent's predecessors could be amortized by respondent over the life of the bonds and a prorated proportion deducted annually from taxable income in the years 1920 to 1925, inclusive.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are contained in the Appendix, *infra*, pp. 12–13.

STATEMENT

This case (involving four consolidated causes) was tried before the District Court, jury being waived, upon a stipulation of facts which may be summarized as follows:

The Western Maryland Rail Road Company, a corporation of the State of Maryland, sold and issued over the period from October, 1902 to December, 1908, $42,518,000 first mortgage 4 per cent

bonds at a discount of $3,021,351.67 (R. 30). On March 5, 1908, a receiver was appointed for that company, and, in proceedings brought to foreclose a second mortgage, its entire property was sold to a reorganization committee representing the holders of bonds issued under said second mortgage (R. 30). Thereafter, the property was sold and conveyed to The Western Maryland Railway Company, a new corporation created under the laws of Maryland for the purpose of acquiring and operating said property (R. 30). As a part of the purchase price of said property The Western Maryland Railway Company assumed the obligation of the bonds which had been issued at a discount (R. 30–31).

In July and August, 1911, The Western Maryland Railway Company sold additional bonds in the face amount of $4,115,000 at a total discount of $617,100. These bonds were issued in the name of Western Maryland Rail Road Company, were identical in every way with the bonds theretofore sold at a discount by that company, and were secured by the same mortgage (R. 30).

On February 15, 1917, The Western Maryland Railway Company was consolidated with its subsidiaries, and the property conveyed to respondent, Western Maryland Railway Company, in accordance with a consolidation agreement (R. 32). Such of the aforesaid bonds as then remained outstanding were recognized by the respondent on its

books as its own obligations. However, no part of the discount at which the bonds were originally sold was brought forward as such or amortized on respondent's books, or amortized in its reports to the Interstate Commerce Commission (R. 35), nor had such discount been amortized on the books of Western Maryland Rail Road Company or The Western Maryland Railway Company (R. 31).

In the determination of respondent's taxable income for the years 1920 to 1925, inclusive, the Commissioner of Internal Revenue did not allow as a deduction from income any part of the said bond discount (R. 37). In its returns for 1920, 1921, and 1922, the respondent did not claim the right to make such deductions (R. 35–36). The respondent instituted four suits to recover taxes for the years 1920 to 1925, inclusive, two of which named the United States as defendant (for 1920 taxes) and the others of which named the Collector as defendant.

The suits were consolidated in the District Court (R. 17–21). That court gave judgment for the respondent, holding that the judgment in its favor in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), was *res adjudicata* in the instant case.[1] The Circuit Court of Appeals affirmed the judgment of the District Court (R. 57).

[1] *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), involved a petition for review of a decision of the Board of Tax Appeals. The Board had held that the respondent was not entitled for the years 1918 and 1919 to

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that its previous decision in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695, was *res adjudicata* of the issues herein.

2. In failing to consider the instant case on the merits.

3. In failing to hold that the respondent was not entitled to the claimed deductions for amortization of discount on bonds sold by other corporations.

4. In affirming the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below that the judgment in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), involving the tax years 1918 and 1919, was *res adjudicata* of the issues in the suits involved here, relating to the tax years 1920 to 1925, inclusive, involves a question of great importance in the administration of the revenue laws, and we believe it to be erroneous for the following reasons:

(a) The decision disregards the provisions of the Revenue Acts which treat each taxable year as a unit. Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359. The statutes authorize the Commissioner

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annual deductions of an amortized portion of the discount on the bonds which had been issued by its predecessors. The decision of the Board was reversed by the Circuit Court of Appeals.

of Internal Revenue to determine a deficiency for *any year* in which he determines that the tax has been underpaid,[2] and afford to taxpayers the opportunity to bring suit for the recovery of taxes paid in any year.[3] The statutes thus authorize suits relating to the taxes for particular years without regard to litigation which may have been instituted as to other years and treat each taxable year as a separate unit.[4] The decision of the court below deprives these provisions of this effect, for under it a decision as to one year is forever binding as to later years. This result seems to be opposed to the rule that where cumulative remedies are given by statute the doctrine of *res adjudicata* is not a bar to a second suit. *United States* v. *Ness*, 245 U.S. 319; see also *Maney* v. *United States*, 278 U.S. 17, 23; *Tutun* v. *United States*, 270 U.S. 568, 580.

(b) The decision of the court below seems to be inconsistent with the decision of this Court in

[2] Section 250, Revenue Act of 1921 (c. 136, 42 Stat. 227); Section 274, Revenue Acts of 1924 (c. 234, 43 Stat. 253; U.S.C., Title 26, Sec. 1048) and 1926 (c. 27, 44 Stat. 9; U.S.C.App., Title 26, Sec. 1048).

[3] Section 1318, Revenue Act of 1921 (U.S.C., Title 26, Sec. 156); Section 1014 (a), Revenue Act of 1924 (U.S.C., Title 26, Sec. 156); Section 1113, Revenue Act of 1926 (U.S.C. Sup. VI, Title 26, Sec. 1672).

[4] The application of the doctrine of *res adjudicata* is not necessary to protect taxpayers against vexatious renewal of litigation where the applicable rules have been judicially settled, for if the conduct of taxing officers becomes unduly arbitrary or oppressive, the remedy of injunction is available. See *Miller* v. *Standard Nut Margarine Co.*, 284 U.S. 498.

United States v. *Stone & Downer Co.*, 274 U.S. 225, where the doctrine of *res adjudicata* was held inapplicable to decisions dealing with the proper classification of imports, and the same reasoning indicates that the doctrine should not be applied in litigation involving different tax years.

(c) The facts presented in the present suits differ from the facts considered in the earlier case. These differences in fact are discussed in the opinion of the District Court (R. 41–43), but that court rejected the Government's contention on this point, as did the court below (R. 53–54). Other differences in fact have been considered material by the Board of Tax Appeals. See *Missouri Pacific R.R. Co.* v. *Commissioner*, 22 B.T.A. 267.[5]

(d) The rule applied by the court below will necessarily result in gross inequalities in the administration of the revenue laws and give preference to

[5] It may be noted also that perhaps the parties in two of the suits here involved may be regarded as different from the parties involved in the earlier case. In two of the present cases the Collector was defendant while in the others the United States was defendant. This Court has held that a prior judgment against a Collector does not bind the Commissioner or the United States. *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U.S. 308; *Sage* v. *United States*, 250 U.S. 33. But the Court has not considered whether a different rule obtains where the situation is reversed. There are, however, District Court decisions holding that where the first suit is against the United States, judgment therein is binding in a subsequent suit against the Collector. *Second Nat. Bank of Saginaw* v. *Woodworth*, 54 F. (2d) 672 (E.D. Mich.); *Greylock Mills* v. *White*, 55 F. (2d) 704 (D. Mass.); *Bertelsen* v. *White*, 58 F. (2d) 792 (D. Mass.).

those taxpayers who successfully litigate a tax question over others who may be subject to tax liability as the result of a later decision of controlling authority laying down a different rule. For example, if the interpretation of the affiliation statutes by this Court in *Handy & Harman* v. *Burnet*, 284 U.S. 136, may not be applied to all corporations without regard to erroneous decisions granting affiliation in prior years, discrimination, injustice, and confusion will result. The startling consequences of such a rule can hardly be exaggerated. Under a rule of this kind, the interests of the Government could not be adequately protected unless appeals were taken and writs issued by this Court to review every questionable decision in Federal tax cases. Unless all such cases were brought to this Court, there would be created a class of taxpayers privileged in the permanent enjoyment of tax exemptions predicated upon the decisions of the lower Federal courts later declared to be erroneous and overruled. Decisions in suits involving particular tax years should conclusively settle the validity of the assessment or collection in question, but should be given no wider scope.

The question of the scope of the doctrine of *res adjudicata* in tax cases is of sufficient general importance to require review of this case. If the decision stands uncorrected, it will necessarily have a profound effect upon the administration of the revenue laws and upon the conduct of tax litigation by the Government, for the reasons stated above.

2. Upon the merits the case also presents a question which should be reviewed. As the court below held that its earlier decision was *res adjudicata* of the issues in this case, it did not pass upon the merits. We believe that it is clear that the petitioner was not entitled to amortize bond discount because it did not issue the bonds. The right to amortize bond discount is conferred by regulation. Articles 544 and 563, Regulations 45 (1920 ed.); Articles 545 (3) (a) and 563, Regulations 62 and 65 (*infra*, pp. 12–13). The regulations in terms limit deduction to the corporation which sells its bonds at a discount.

In its earlier decision (33 F. (2d) 695), the court below held that the respondent was entitled during the tax years there involved to amortize discount on bonds sold by its predecessors. The court placed this conclusion upon the grounds (1) that there was only a technical legal difference between the respondent and its predecessors which the court should disregard and accordingly that the respondent was entitled to make the deduction as if no reorganization had occurred; (2) that by acquiring the assets and assuming the liabilities of its immediate predecessors the respondent became entitled to deduct the bond discount.

So far as the earlier decision was based upon disregard of corporate entities, it seems to be opposed in principle to the decisions of this Court in *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S.

415; *Burnet* v. *Clark,* 287 U.S. 410; *Dalton* v. *Bowers,* 287 U.S. 404. The Board of Tax Appeals has declined to follow it. See *Missouri Pacific R.R. Co.* v. *Commissioner,* 22 B.T.A. 267; *Southern Railway Co.* v. *Commissioner,* 27 B.T.A. —.

The respondent is a separate entity distinct from the corporations which issued the bonds.[6] New taxable entities succeeding to the assets and liabilities of predecessors do not necessarily acquire their right to deductions. See *Athol Manufacturing Co.* v. *Commissioner,* 54 F. (2d) 230 (C.C.A. 1st); *The Maytag Co.* v. *Commissioner,* 17 B.T.A. 182. Cf. *Planters Cotton Oil Co.* v. *Hopkins,* 286 U.S. 332. Since the petitioner sold no bonds at a discount it was not entitled through succession to a deduction for a discount incurred by others.

Nor was the respondent entitled to the deduction because it had assumed liabilities and acquired

[6] The consolidation which created the respondent was accomplished under the laws of Maryland and Pennsylvania. (Chap. 553 of the Acts of 1890 of the General Assembly of Maryland, as amended by Chap. 664 of the Acts of 1916, being Article 23, Sec. 218, Bagby's Ann. Code of Maryland; Pennsylvania Acts of March 24, 1865, P.L. 49, and April 10, 1869, P.L. 24 (R. 32).) The courts in both States hold that the consolidating companies go out of existence and that a new corporation is created. *State, use of Dodson* v. *Balto. & Lehigh R.R. Co.,* 77 Md. 489; *Diggs* v. *Fidelity & Deposit Co.,* 112 Md. 50; *Thom* v. *Baltimore Trust Co.,* 158 Md. 552; *Dalmas* v. *Philipsburg & S. Val. R.R. Co.,* 254 Pa. 9. See *Penna. Utilities Co.* v. *Pub. Serv. Com.,* 69 Pa.S.Ct. 612; *York Haven W. & P. Co.* v. *Pub. Serv. Com. et al.,* 287 Pa. 241; *Buist's Estate,* 297 Pa. 537.

assets of the predecessor corporations. In the earlier case it seems to have been considered that the issuing corporations had amortized the bond discount on their books, but the stipulation in the present case is to the contrary (R. 31). As the respondent assumed the liability on the bonds at their full face value there was no discount by it to be amortized. The Board of Tax Appeals has held that similar new corporations are not entitled to amortize discount by reason of assumption of liabilities of the issuing corporation. *Missouri Pacific R.R. Co.* v. *Commissioner,* 22 B.T.A. 267, *supra; Southern Railway Co.* v. *Commissioner,* 27 B.T.A. —, *supra.*

If the question of *res adjudicata* is reviewed by this Court, the case should also be considered on its merits, since the earlier decision of the court below is erroneous and involves, in part, a departure from principles recognized in recent decisions of this Court.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.

APRIL, 1933.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * *.

[The same provision appears in Section 234 (a) (2) of the Revenue Acts of 1921 (c. 136, 42 Stat. 227, 254) and 1924 (c. 234, 43 Stat. 253, 283; U.S.C., Title 26, Sec. 986).]

Treasury Department Regulations 45 (1920 Edition):

> ART. 544. *Sale and retirement of corporate bonds.*— * * *.
>
> * * * * *
>
> (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of

discount not yet deducted) is a deductible expense for the taxable year. * * *

ART. 563. *Sale of capital stock, bonds, and capital assets.*— * * *. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid * * *.

[The same provisions appear in Article 545 (a) (3) and Article 563 of Treasury Department Regulations 62 and 65.]

U. S. GOVERNMENT PRINTING OFFICE: 1939

FILE COPY

No. 342

In the Supreme Court of the United States

October Term, 1932

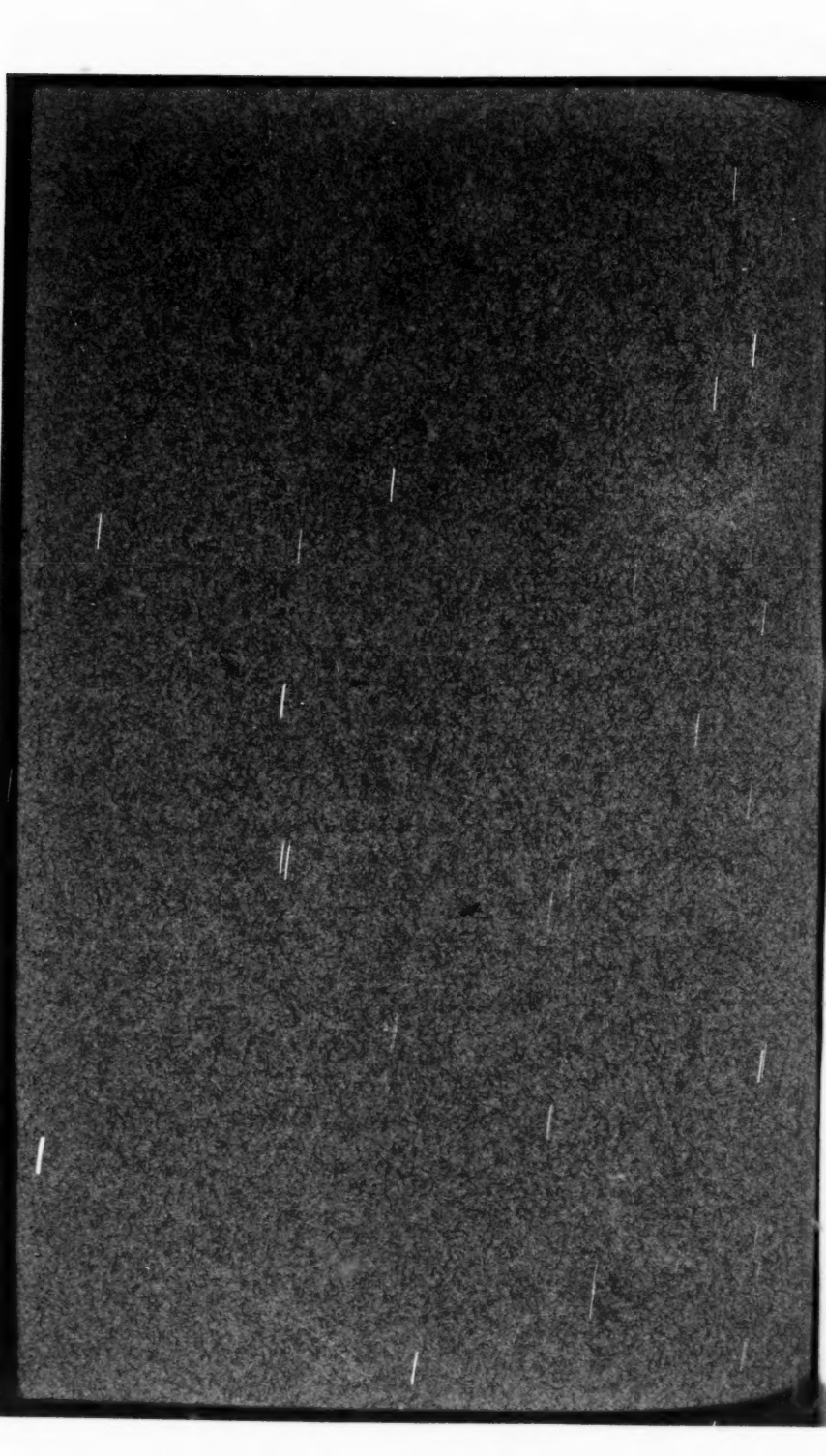
GALEN L. TAFT, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

v.

WESTERN MARYLAND RAILWAY COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER



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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 842

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, petitioner

v.

WESTERN MARYLAND RAILWAY COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court for the District of Maryland (R. 38–45) is reported in 53 F. (2d) 211. The opinion of the Circuit Court of Appeals for the Fourth Circuit (R. 52–56) is reported in 62 F. (2d) 933.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933 (R. 57). Petition for a writ of certiorari was filed April 7, 1933, and was

granted April 24, 1933. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an earlier decision of the Circuit Court of Appeals for the Fourth Circuit in a proceeding involving other tax years was *res adjudicata* of the issues herein.

2. Whether the discount on bonds sold prior to March 1, 1913, by respondent's predecessors could be amortized by respondent over the life of the bonds and a prorated proportion be deducted annually from taxable income in the years 1920 to 1925, inclusive.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are contained in the Appendix, *infra*, pp. 33–34.

STATEMENT

This consolidated cause, a jury being waived, was tried before the District Court upon a stipulation of facts (R. 29) which may be summarized as follows:

The Western Maryland Rail Road Company (hereinafter sometimes called Company No. 1), a corporation of the State of Maryland, sold and issued over the period from October 1902 to December 1908, $42,518,000 first-mortgage 4 per cent bonds at a discount of $3,021,351.67 (R. 30). On March 5, 1908, a receiver was appointed for that company, and, in proceedings brought to foreclose

a second mortgage, its entire property was sold to a reorganization committee representing the holders of bonds secured by the second mortgage (R. 30). Thereafter, the property was sold and conveyed to The Western Maryland Railway Company (hereinafter sometimes called Company No. 2), a new corporation created under the laws of Maryland, for the purpose of acquiring and operating said property (R. 30). As a part of the purchase price of said property The Western Maryland Railway Company assumed the obligation of the first-mortgage bonds which had been issued at a discount (R. 30–31).

In July and August 1911 The Western Maryland Railway Company sold additional bonds in the face amount of $4,115,000 at a total discount of $617,100. These bonds were issued in the name of Western Maryland Rail Road Company, were identical in every way with the first-mortgage bonds theretofore sold at a discount by that company, and were secured by the same mortgage (R. 30).

On February 15, 1917, The Western Maryland Railway Company was consolidated with its subsidiaries, and the property conveyed to respondent, Western Maryland Railway Company (hereinafter sometimes called Company No. 3), in accordance with a consolidation agreement (R. 32). Such of the aforesaid bonds as then remained outstanding were recognized by the respondent (Company No. 3) on its books as its own obligations. However, no part of the discount at which the

bonds were originally sold was brought forward as such or amortized on respondent's books, or amortized in its reports to the Interstate Commerce Commission (R. 35), nor had such discount been amortized on the books of Western Maryland Rail Road Company (Company No. 1) or The Western Maryland Railway Company (Company No. 2) (R. 31).

In the determination of respondent's taxable income for the years 1920 to 1925, inclusive, the Commissioner of Internal Revenue did not allow as a deduction from income any part of the said bond discount (R. 37). In its returns for 1920, 1921, and 1922, the respondent did not claim the right to make such deductions (R. 35–36). The respondent instituted four suits to recover taxes for the years 1920 to 1925, inclusive, two of which named the United States as defendant (for 1920 taxes) and the others of which named the Collector as defendant (for 1920–1925 taxes).

The suits were consolidated in the District Court (R. 17–21). That court gave judgment for the respondent, holding that the judgment in its favor in *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), was *res adjudicata* in the instant case.[1] The Circuit Court of Appeals affirmed the judgment of the District Court (R. 57).

[1] *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C.C.A. 4th), involved a petition for review of a decision of the Board of Tax Appeals. The Board had held that the respondent was not entitled for the years 1918 and 1919 to

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that its previous decision in *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695, was *res adjudicata* of the issues herein.

2. In failing to consider the instant case on the merits.

3. In failing to hold that the respondent was not entitled to the claimed deductions for amortization of discount on bonds sold by other corporations.

4. In affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

Various provisions of the Revenue Acts show that Congress intended that each tax year should be treated as a unit, and that the proceedings in respect of the tax for each year constitute a separate cause of action. Under these statutes the rule of *res adjudicata* or estoppel by judgment should not be applied where different tax years are involved for somewhat the same reasons of policy which induced this Court not to apply the rule in *United States* v. *Stone & Downer Co.,* 274 U.S. 225. Application of the rule of *res adjudicata* to Federal tax cases involving different years would result in inequality and confusion and produce other mischievous consequences. Public policy re-

annual deductions of an amortized portion of the discount on the bonds which had been issued by its predecessors. The decision of the Board was reversed by the Circuit Court of Appeals.

quires that an erroneous decision in one tax year should not be forever perpetuated by the application of the doctrine. If applied here, it would prevent consideration of the true facts which were in part not before the court below when its earlier decision was rendered. Even if otherwise applicable, the doctrine of *res adjudicata* may not apply in such of the present suits as are against the Collector.

Upon the merits, the respondent was not entitled to the deduction of bond discount on bonds sold by its predecessors. The right to deduct bond discount is conferred by Treasury Regulations which confer it only upon the corporation issuing the bonds. The respondent did not issue the bonds and was a new taxable entity. There is no basis for disregarding its corporate entity or for giving it the right of deduction by succession. The assumption of the assets and liabilities of its predecessors did not give it the right to the claimed deduction.

ARGUMENT

I

THE DOCTRINE OF RES ADJUDICATA SHOULD HAVE NO APPLICATION IN SUITS INVOLVING FEDERAL TAXES FOR DIFFERENT YEARS

The court below decided that the question of the respondent's right to amortize and deduct bond discount in its tax returns for the years 1920 to 1925 was *res adjudicata* by reason of its earlier decision in a case involving the right to amortize

and deduct during the tax years 1918 and 1919. *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C.C.A. 4th). We contend that this decision is erroneous and that the judgment in the earlier case was not conclusive of the issues in the instant case.

We believe that the provisions of the Federal Revenue Acts conclusively show that Congress intended not only that each tax year should be treated as a unit (cf. *Burnet* v. *Sanford & Brooks,* 282 U.S. 359; *Burnet* v. *Thompson Oil & Gas Co.,* 283 U.S. 301, 306), but that the proceedings in respect of the tax for each tax year should constitute a separate cause of action and that a judgment as to one tax year should not operate to estop either the Government or the taxpayer from litigating any issue relating to the tax for a subsequent year.

Congress has authorized the Commissioner of Internal Revenue to determine a deficiency for *any year* in which he determines that the tax has been unpaid.[2] The Revenue Acts afford to taxpayers the opportunity to bring suit for the recovery of taxes paid in any year.[3] These statutes disclose the policy of Congress to make the courts available to the Government and taxpayers alike for the pur-

[2] Section 250, Revenue Act of 1921 (c. 136, 42 Stat. 227); Section 274, Revenue Acts of 1924 (c. 234, 43 Stat. 253; U.S.C., Title 26, Sec. 1048) and 1926 (c. 27, 44 Stat. 9; U.S.C.App., Title 26, Sec. 1048).

[3] Section 1318, Revenue Act of 1921 (U.S.C., Title 26, Sec. 156); Section 1014 (a), Revenue Act of 1924 (U.S.C., Title 26, Sec. 156); Section 1113, Revenue Act of 1926 (U.S.C. Sup. VI, Title 26, Sec. 1672).

pose of determining questions arising under the Revenue Acts, without being precluded by litigation which may have been instituted as to other years, thus treating each taxable year separately and giving the parties the benefit for the new taxable period of any recent decisions of the courts.

In harmony with this Congressional policy, the statutes have required that where changes in Treasury Regulations were occasioned by a decision of a court of competent jurisdiction, they should be given retroactive effect.[4] The statutes authorize closing agreements between the taxpayer and the Government to settle the tax liability for any year,[5] and the Board of Tax Appeals has held that such an agreement "bars only the reopening of tax liability for the year covered thereby and in no way estops the petitioner from pleading and proving any fact overlooked in such year but related to the tax of a subsequent year." *W. C. Mitchell Co.* v. *Commissioner*, 27 B.T.A. —.

Congress has likewise legislated specially with respect to certain situations in order to save the Gov-

[4] Section 1314, Revenue Act of 1921; Section 1008 (a), Revenue Act of 1924 (U.S.C., Title 26, Sec. 1251); Section 1108 (a), Revenue Act of 1926 (U.S.C.App., Title 26, Sec. 1251). Compare Section 605, Revenue Act of 1928, 45 Stat. 791, 874 (U.S.C. Sup. V, Title 26, Sec. 1251).

[5] Section 1312, Revenue Act of 1921; Section 1006, Revenue Act of 1924 (U.S.C., Title 26, Sec. 1249); Section 1106 (b), Revenue Act of 1926 (U.S.C.App., Title 26, Sec. 1249; Section 606, Revenue Act of 1928, c. 852, 45 Stat. 791 (U.S.C. Sup. VI, Title 26, Sec. 1660).

ernment's right of resettlement in the event of the favorable outcome of test suits. *Poe* v. *Seaborn,* 282 U.S. 101, 116. The Board of Tax Appeals seems to have positive authority to reexamine the facts with relation to the taxes for other taxable years so far as may be necessary to determine correctly the tax in a different year pending before it. Section 274 (g), Revenue Act of 1926, U.S.C.App., Title 26, Sec. 1049 (b).

A distinction has been drawn between the operation of a judgment where a second action is brought upon the identical cause of action involved in an earlier case and where, although the second action is on a different cause of action, an issue determined in an earlier suit is involved. *Cromwell* v. *County of Sac,* 94 U.S. 351. In the first situation all claims which might have been litigated pass into the judgment and the judgment is *res adjudicata* of the second suit. Where, however, the suit is based upon a different cause of action, the judgment in the first suit operates as an estoppel only as to issues actually decided therein and involved in the second suit.

The statutory scheme referred to above discloses that the subject matter of a tax suit is the tax for the particular year involved and, accordingly, that suit for a particular year involves a different cause of action from a suit for any other year. See *Ford* v. *Commissioner,* 51 F. (2d) 20¢ (C.C.A. 6th), certiorari denied, 284 U.S. 666. Indeed, it is not disputed that the present suits involve causes of ac-

tion different from the proceeding involved in the earlier decision of the court below. The sole question is whether the determination of the issue of the respondent's right to deduct amortized discount on the bonds sold by its predecessors in the earlier decision necessarily constitutes an estoppel by judgment which precludes a reconsideration of the question in this case. In view of the serious consequences which would result from the application of the rule of estoppel by judgment to Federal tax cases involving different tax years, we believe that the statutes should be construed as preventing the application of that rule in Federal tax cases involving different years.

The decision in *United States* v. *Stone & Downer Co.*, 274 U.S. 225, dealing with an analogous problem, indicates the principle which we believe should be applied and some of the considerations which should govern decision in this case. The question there involved was whether a judgment of the Court of Customs Appeals deciding the classification of goods upon their importation under the Tariff Acts, was *res adjudicata*, estopping the Government as to the treatment of another importation of the same kind of goods by the same importer. The Court approved the practice of the Court of Customs Appeals in treating such adjudications as not binding in a subsequent proceeding, and held that the doctrine of *res adjudicata* was not to be applied. The Court observed that application of the doctrine

would result in inequality and discrimination in the administration of the customs laws if a permanently binding effect were to be given in all subsequent cases to an earlier decision, itself possibly contrary to the correct rule, favorable to one importer. Thus, we believe that the Court concluded that the doctrine must give way in the face of compelling considerations of policy. Substantially the same considerations indicate that it should not be applied here.

In tax cases arising under the Federal revenue laws, it is apparent that the application of the doctrine of *res adjudicata* or estoppel by judgment would result in inequality in the administration of the laws and would produce mischievous consequences in the conduct of litigation and in the work of the appellate courts.

For example, if the interpretation of the affiliation statutes by this Court in *Handy & Harman* v. *Burnet,* 284 U.S. 136, is not applicable to all corporations regardless of erroneous but unreversed decisions of lower courts granting affiliation in prior years, discrimination, injustice, and confusion would result. In every situation where the tax liability is a recurrent one founded upon an unchanged status of the taxpayer, a decision as to one tax year, either for or against the Government, would, if deemed a binding adjudication for all subsequent years, create an acutely embarrassing condition both administratively and in terms of the

public revenues. Should final judgments of the lower courts be applied as binding determinations in later years, the interests of the Government could be protected only by bringing to this Court every questionable decision in a Government tax case rendered in the lower courts.[6] Unless all such cases were brought to this Court, decisions of the lower Federal courts, even though later declared to be erroneous and overruled, would create a numerous class of taxpayers privileged in the permanent enjoyment of tax exemptions. For example, in *Barnet* v. *Jergins Trust*, No. 541, October Term, 1932, decided March 13, 1933, it was held by this Court that a lessee of certain municipal property was not immune from Federal income tax upon the profits derived from the leased premises. The lower court, however, had held otherwise. If the matter had not been brought here for review at the time it was, the taxpayer in that case, under the ruling of the court below in the case at bar, would be permanently relieved of income taxation even

[6] Since the amendment of the Judicial Code in 1925, there is a limited right of review in this Court. Following this Court's indication of the character of reasons which would be considered as sufficient to justify granting a writ of certiorari (Rule 38, par. 5), it is only in exceptional cases that the Government petitions for the writ in the absence of conflict of decisions. The Government also refrains from making applications for writs in cases where the record fails to present fully the question at issue or is otherwise defective. The files of the Department of Justice show that it was for the latter reason that no petition was presented in the case now held to constitute a bar.

though, in a case subsequently arising, this Court had held that a taxpayer in like circumstances was not immune.

Nor, under the theory of the decision of the court below, would the injustice invariably fall upon the Government. In *Waller* v. *Commissioner,* 40 F. (2d) 892 (C.C.A. 5th), certiorari denied, 282 U.S. 889, and *Herold* v. *Commissioner,* 42 F. (2d) 942 (C.C.A. 5th), it was held that members of certain partnerships were not entitled to allowances for depletion of their respective interests in oil and gas leases which had been held by the partnership. According to the decision below in the instant case the taxpayers there would be bound for all future years by the decision of the Circuit Court of Appeals. But in *Palmer* v. *Bender,* 287 U.S. 551, it was decided by this Court that a member of the identical partnership was entitled to a depletion allowance with respect to the same interests involved in the *Waller* and *Herold cases.* If the doctrine of *res adjudicata* were applied, the several members of this partnership would in future years be taxed upon different bases and at different rates upon interests of precisely the same scope and incidents. Similarly, in *Burnet* v. *Logan,* 283 U.S. 404, it was held that the annual receipts from a certain contract were to be considered a return of capital and were not taxable as income. A contrary conclusion had been reached with respect to the receipts of another taxpayer under the identi-

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cal contract. *Hitchcock* v. *Commissioner,* 44 F. (2d) 756 (C.C.A. 6th). Upon rehearing the latter decision was reversed on the authority of *Burnet* v. *Logan,* but if the time for rehearing or review had elapsed, and had the rule of *res adjudicata* been applicable, unjust exactions from Hitchcock for years to come would have been legalized by a decision contrary to the holding of this Court.

Where, as here, and in Federal tax cases generally, an erroneous decision as to a taxpayer's liability for a particular year will result in inequality and discrimination,[7] public policy plainly requires that the error should not be perpetuated in years to come, but that the taxpayer's liability in other years should be open to reconsideration in the light of the lessons of experience, the force of better reasoning or a more complete disclosure of the facts. Cf. *O'Brien* v. *Wheelock,* 184 U.S. 450.

The instant case discloses a situation where if the true facts had been presented in the earlier case a contrary result would in all probability have been reached. Certain facts were assumed by the court in the prior suit which the record in

[7] In *Long* v. *Rockwood,* 277 U.S. 142, it was held that a State may not tax the income received by one of its citizens as royalties for the use of patents issued to him by the United States. In *Fox Film Corporation* v. *Doyal,* 286 U.S. 123, *Long* v. *Rockwood* was "definitely overruled." If the ruling of the court below in the instant case is sound, Rockwood would be forever immune from future taxation by Massachusetts on the income from patents issued to him, though the State would be at liberty to tax any other citizen similarly situated.

the present suit shows to be different. This case involves the relationship of three different companies. The greater amount of the bonds involved was issued by Western Maryland Rail Road Company (Company No. 1), and the balance by The Western Maryland Railway Company (Company No. 2). None of the bonds was issued by respondent, Western Maryland Railway Company (Company No. 3). In the earlier case, it was erroneously stipulated that Company No. 1 "may be taken as identical" with Company No. 2, and the Circuit Court of Appeals accordingly treated the case as though the bonds had been issued by Company No. 2 under its own mortgage. The record in the instant case shows the true situation, which is more fully set forth *infra* (footnote 12) (R. 30–31). It shows further that the bond discount in question had not been amortized on the books of either Company No. 1 or Company No. 2, although the Circuit Court of Appeals had assumed the contrary in the earlier decision. Hence, it would seem that the question in this proceeding in so far as it affects the bonds issued by Company No. 1, was not determined in the earlier case; application of the doctrine of estoppel would prevent a consideration of that question in the light of the true facts.

So far as we are aware, it has never been supposed by this Court that the first decision regarding a Federal tax question recurring from year to year with respect to many taxpayers, was forever bind-

ing between the parties to the first adjudication. For instance, in *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, the question involved had been previously litigated between the same parties, without barring recourse to this Court in a dispute involving a tax for a subsequent year.

Moreover, where cumulative remedies are given by statute the doctrine of *res adjudicata* is not a bar to a second suit. This rule was applied in *United States* v. *Ness*, 245 U.S. 319, where a suit was brought in a United States District Court under Section 15 of the Naturalization Act to cancel a certificate of naturalization which had been issued in a proceeding under Section 11. It was held that the decision in the first proceeding was not *res adjudicata*, but that the United States, after having entered its appearance in the naturalization court, might file an independent suit to cancel the certificate and urge the very grounds which were overruled by the naturalization court. The basis of the decision was that Congress had authorized both proceedings. That reasoning is equally pertinent here, for Congress has authorized a separate proceeding with respect to each year's tax. See also *Maney* v. *United States*, 278 U.S. 17, 23; *Tutun* v. *United States*, 270 U.S. 568, 580.

It is true that the doctrine of *res adjudicata* has been applied in cases involving State taxation. See *New Orleans* v. *Citizens' Bank*, 167 U.S. 371, but cf. *Keokuk & Western R.R. Co.* v. *Missouri*, 152 U.S. 301, 314. But the principle laid down in the

New Orleans case, we believe, should not be extended to cases like the present; the Court refused to apply it in *United States* v. *Stone & Downer Co., supra,* for reasons closely similar to those we now urge against it.[8] In *New Orleans* v. *Citizens' Bank, supra,* the question was whether a taxpayer was exempt from taxation by virtue of a particular contract made between it and the State. While the power to tax was ultimately at issue, the real dispute concerned the interpretation of a contract of no general application, but peculiar to the taxpayer then involved. Until and unless that contract was changed the intrusion of new issues or changed conditions was extremely unlikely; the interpretation of the contract, while affecting the power of the State to tax, did not have immediate effect upon any other taxpayers, nor by giving it binding effect for the future was one taxpayer relieved from taxation which in the same circumstances others were forced to bear. See *United States* v. *Stone & Downer Co., supra,* p. 237. The decision in that case, limited as it is by *National Bank of Louisville* v. *Stone,* 174 U.S. 432, is readily distinguishable from cases like the present, where

[8] Although it did not rest its decision upon that ground, the Board of Tax Appeals in *Haller* v. *Commissioner,* 26 B.T.A. 395, apparently considered that the doctrine of *res adjudicata* applied to cases involving Federal taxes for different years. In the Court of Appeals of the District of Columbia, where the case is now pending on review (No. 5844), the Government's brief makes no argument in support of the application of the doctrine, and the court has been advised that we are taking a contrary position here.

laws of general application are involved and where numerous taxpayers are similarly situated.

In *Deposit Bank* v. *Frankfort,* 191 U.S. 499, the Court held that a prior adjudication by this Court that there was a contract of exemption from taxation, in favor of a taxpayer, prevented relitigation in a State court of the question whether such a contract existed. While the effect of the decision was to exempt one bank from taxation to which others might be subject, the decision really turned upon the duty of a State court to give effect to a final judgment of this Court. It had been decided, in *Stone* v. *Deposit Bank,* 174 U.S. 800, that the bank had proved an irrevocable contract with the State involving the scope of the latter's power to tax. That decision was based on rulings of the State courts, which were subsequently overruled. When these rulings were overruled in later State decisions and it was sought to subject the bank to taxation, this Court held that such an attempt if successful would impair the obligation of a contract declared to exist by the Federal courts, whose decisions had not been modified or set aside by any court of competent jurisdiction. It is true that the opinion of this Court contains language indicating readiness to adhere to the technical rules of *res adjudicata* even in tax cases, but apparently the true *ratio decidendi* was that the State court had no power to impair the obligations of a contract the validity of which had been adjudicated in the de-

cree of the Federal court. That this was the real nature of the case is evidenced by the dissenting opinion of Chief Justice Fuller, concurred in by Justices Brewer, Brown, and Peckham, which was directed to the proposition that the State court in rendering judgment for taxes in years not involved in the first case before this Court, did not refuse to give the Federal decree such effect as it was entitled to. Our analysis of the case is further supported by the circumstance that in Kentucky, where the case arose, "an adjudication concerning taxes for one year cannot be pleaded as an estoppel in suits in that State involving the taxes of other years." *Deposit Bank* v. *Frankfort, supra,* p. 514. And it is settled, as this Court said in *United States* v. *Stone & Downer Co., supra,* p. 231, that "a judgment not operating as *res judicata* in suits for taxes for another year in the state court will not be an estoppel in a federal court for subsequent years. *Phoenix Fire and Marine Insurance Co.* v. *Tennessee,* 161 U.S. 174; *Covington* v. *First National Bank of Covington,* 198 U.S. 100." Hence the *Deposit Bank case* apparently went off on the validity of the contract which had been previously adjudicated, rather than on the application of the rules of *res adjudicata* to taxes recurring annually. In *Covington* v. *First National Bank, supra,* pp. 108–109, Justice Day, who had delivered the opinion of the Court in *Deposit Bank* v. *Frankfort,* explained that case as follows: "* * * in that case the

court was dealing with the effect to be given to a judgment of a Federal court in which such contract right had been adjudicated, when the Federal judgment was set up in a state court; * * * The case of *Deposit Bank* v. *Frankfort* was only concerned with the effect to be given to a Federal judgment adjudicating a contract right when pleaded in a state court."

Moreover, so far as we are aware, every case but one in which this Court has applied the rules of *res adjudicata* to suits for State taxes for different years, involved a prior determination that a valid contract exempted the citizen from taxation.[9] See *New Orleans* v. *Citizens' Bank, supra; Deposit Bank* v. *Frankfort, supra; Gunter* v. *Atlantic Coast Line R. Co.,* 200 U.S. 273. It may well be

[9] In *Baldwin* v. *Maryland*, 179 U.S. 220, taxes for the years 1893 and 1894 had been found by the Maryland courts to be due from the guardian of the estate of a minor, notwithstanding the contention that they were both non residents and nonresidents were not subject to the tax. In 1895, the taxes for 1893 and 1894 being still unpaid, the State sued the guardian's bondsmen for the taxes for 1893, 1894, and 1895. This Court observed that the taxes for the first two years had already been litigated. The taxes for 1895, it was said, stood on no other footing, and the ruling as to them was "determined by the conclusion in respect to the taxes of 1893 and 1894." There was no discussion of the problem of *res adjudicata* as to tax matters; the Court merely cited a case involving royalties from patents, another involving the location of mining claims, and finally *New Orleans* v. *Citizens' Bank, supra.* The Court declined to pass on the question whether the adjudication of the dispute between the State and the guardian was binding also on the latter's bondsmen.

that where a *contract* is involved, a judgment in a tax suit for one year, holding that there is an exemption from taxation, may have the effect of restraining all future attempts to tax. For there, the thing adjudged is that the citizen has a contract which may not be impaired by any act of the State. If, subsequent to a decision that such a contract exists, a State court may judicially declare its non-existence and consequent non-impairment, the protection intended to be furnished by the Constitution is of small value. As was said in *Berryman* v. *Whitman College,* 222 U.S. 334, 346–347:

> * * * to deny in a case of contract exempting from taxation the right to a decree co-extensive with the power to tax which the contract restrained would be in and of itself an impairment of the contract, since if judicial power was not adequate to control by the thing adjudged the right to a contract exemption and to prevent violations of such right, the power to contract would be of no avail.

We submit that in Federal tax cases the doctrines of *res adjudicata* or estoppel by judgment should be limited to suits on the same cause of action. We believe that no decisions of this Court require extension of the doctrines to suits involving Federal taxes for different years and, therefore, upon different causes of action. The serious consequences of extending the application of the doctrines to such cases are indicated above; refusal to extend them would lead to no burdensome conse-

quences. Experience shows that neither the Government nor the taxpayers are inclined to relitigate questions of fact once decided, although apparently it has not heretofore been supposed that the renewal of litigation for different tax years was prevented by the rules of *res adjudicata*. There is no reason to believe that if the judgment herein is reversed renewals of such litigation would increase.[10] Nor if our contentions are upheld would there seem to be danger of an expanded volume of litigation concerning issues of law or of mixed law and fact previously adjudicated between the same parties as to other tax years.[11] The rule of *stare decisis* renders fruitless repeated appeals to the courts in unmeritorious cases.[10]

No rule of public policy should, by automatic application of the forms in which the rule has become molded by constant repetition, be permitted to dis-

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[10] However, as we have indicated above, affirmance of the judgment below would necessarily increase the burden of the appellate courts since, for its protection, the Government would be compelled to appeal from every doubtful decision and to seek review by certiorari in many cases not now customarily presented to this Court.

[11] Moreover, the authority to make Federal tax assessments is not delegated to local collectors; Federal assessments are made only upon the authority of the Commissioner of Internal Revenue, and there is small likelihood that individual taxpayers will be exposed to harassment where the applicable rules have been judicially settled. It has been held that the remedy of injunction is available if the conduct of taxing officers becomes unduly arbitrary or oppressive. See *Miller* v. *Standard Nut Margarine Co.*, 284 U.S. 498.

serve the public welfare for the promotion of which it was originally devised.

Aside from the foregoing considerations, there is a basis for concluding that even if otherwise applicable the doctrine of *res adjudicata* should not be applied to such of the present suits as were against the Collector. The earlier decision was rendered in a case arising between the Commissioner of Internal Revenue and the respondent. In two of the present suits the United States was defendant, while in the other two the Collector was defendant. If, contrary to our belief, the former judgment was otherwise conclusive, it may be conceded for present purposes that it would be binding in the suits against the United States, since the Commissioner of Internal Revenue acted in the earlier suit in his official capacity as a representative thereof. But the decisions of this Court indicate that for purposes of the application of the doctrine of *res adjudicata* the Commissioner (or the United States) and the Collector are to be regarded as different parties. In *Sage* v. *United States,* 250 U.S. 33, it was held that a former judgment against a Collector was not a bar to a subsequent suit by the United States, even where a tax for a single year was involved. In *Bankers Pocahontas Co.* v. *Burnet,* 287 U.S. 308, it was held that a judgment against a Collector was not *res adjudicata* in a sub-

sequent proceeding involving the Commissioner of Internal Revenue, relating to taxes for different years.

Unless the *Sage* and *Bankers Pocahontas Coal Co.* cases are to be distinguished because they both involved situations where the first suit was against the Collector, they may be applicable here, and, if so, the judgment below was certainly erroneous in the suits involving the Collector. The view that the *Sage* case is distinguishable upon the ground stated was adopted in *Second National Bank of Saginaw* v. *Woodworth,* 54 F. (2d) 672 (E.D. Mich.), and in *Bertelsen* v. *White,* 58 F. (2d) 792 (Mass.). In those cases the first suit was against the United States and the second suit was against the Collector, but they both involved proceedings for the same tax year. In this case the court below has relied on the distinction where the suits involved different tax years. In the *Second National Bank of Saginaw* case, the Treasury Department, acting for the Collector on appeal, has argued that the distinction made by the District Court was correct. Since we know of nothing in the decisions of this Court to suggest that such a distinction exists, we submit the matter for consideration. We do not feel justified in urging that the distinction is nonexistent, in view of the position which the Treasury Department has taken, although that position has not received the approval of the Department of Justice.

II

UPON THE MERITS, THE RESPONDENT WAS NOT ENTITLED TO DEDUCT ANY DISCOUNT ON BONDS SOLD BY ITS PREDECESSORS

As the court below held that its earlier decision (33 F. (2d) 695) was *res adjudicata* of the issues herein, it did not consider or pass upon the merits of the present suits. The question on the merits is whether the respondent is entitled to deduct from gross income, annually, an amount for amortized discount upon the bonds sold by its two predecessors. In the earlier decision the court below held that the respondent was entitled to such deduction, but we believe that that decision was clearly erroneous and that upon the merits the present cases should have been decided in favor of the Government.

The claimed right to deduct discount upon the issuance of bonds by a corporation rests entirely upon Treasury Regulations. Article 544 (3) (a), Regulations 45 (1920 edition), provides in part:

> If bonds are issued by a corporation at a discount the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds.

This regulation was based upon the earlier provisions of Article 15, Regulations 33, and was followed by substantially identical provisions in Article 545 (3) (a), Regulations 62, 65, 69, and Article 68 (3) (a), Regulations 74. Article 563, Regulations 45 (1920 edition), provides in part:

> If it (a corporation) sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid * * *

Similar provisions are contained in Article 563, Regulations 62, 65, 69. The reenactment of the provisions of the 1918 Act, construed in Regulations 45, in the 1924 and 1926 Acts, imports legislative approval of the provisions of the regulations. *Old Colony R. Co.* v. *Commissioner,* 284 U.S. 552; see *Massachusetts Mutual Life Insurance Co.* v. *United States,* No. 322, October Term, 1932, decided February 6, 1933; *Burnet* v. *Guggenheim,* No. 283, October Term, 1932, decided February 6, 1933.

By their plain terms the provisions of the regulations authorize the deduction of amortized bond discount only by the corporation which issues the bonds. The bonds with respect to which the respondent seeks to deduct discount were not issued or sold by respondent, but were issued and sold by its predecessors. Under the regulations, therefore, the respondent had no right to deduct the discount.

In its earlier decision the court below reached the conclusion that the respondent was entitled to deduct amortized bond discount upon the bonds sold by its predecessors upon two grounds: (1) that there was only a technical legal difference between the respondent and its predecessors, which the court should disregard, and accordingly that the respondent was entitled to make the deduction

as if no reorganization had occurred; and (2) that by acquiring the assets and assuming the liabilities of its predecessors the respondent became entitled to deduct the discount. It is to be noted that in the original decision the dissenting judge took the view that the respondent and its predecessors were separate legal entities and that the respondent did not in any way acquire the right to deduct any part of the discount.

In reaching the conclusion in its original decision that the respondent was entitled under the regulations to deduct discount on bonds sold by its predecessors the court below necessarily disregarded the fact that the respondent was an entity separate and distinct from its predecessors. Indeed, the court expressly disregarded that fact and treated it as a technicality which must be brushed aside in an effort to regard substance and not form.

The respondent was formed by a consolidation accomplished under the laws of Maryland and Pennsylvania. (Chap. 553 of the Acts of 1890 of the General Assembly of Maryland, as amended by Chap. 664 of the Acts of 1916, being Article 23, Sec. 218, Bagby's Ann. Code of Maryland; Pennsylvania Acts of March 24, 1865, P.L. 49, and April 10, 1869, P.L. 24.) (R. 32.) The courts in both States hold that the consolidating companies go out of existence and that a new corporation is created. *State, use of Dodson* v. *Balto. & Lehigh R.R. Co.*, 77 Md. 489; *Diggs* v. *Fidelity & Deposit Co.*, 112 Md. 50; *Thom* v. *Baltimore Trust Co.*, 158 Md. 352;

Dalmas v. *Philipsburg & S. Val. R.R. Co.*, 254 Pa. 9. See *Penna. Utilities Co.* v. *Pub. Serv. Com.*, 69 Pa.S.Ct. 612; *York Haven W. & P. Co.* v. *Pub. Serv. Com. et al.*, 287 Pa. 241; *Bwist's Estate*, 297 Pa. 537. There are expressions in some of these cases to the effect that the new entity succeeds to the rights and liabilities of the old companies, but such terms do not embrace the results of selling bonds at a discount, and if they did, obviously State law cannot provide a system of succession to deductions under the Federal Revenue Acts. The crucial fact established by State law is that the respondent is a new entity separate and distinct from its predecessors.[12]

After the recent decisions of this Court in *Dalton* v. *Bowers*, 287 U.S. 404; *Burnet* v. *Clark*,

[12] While we believe that the fact that the respondent is a separate corporate entity makes it unnecessary to examine its corporate structure in relation to that of its predecessors, it is entirely clear that even if that is considered, the difference between the corporations was not merely formal; they differed in substance as well. An examination of the capital structures of the three companies reveals marked differences. Company No. 1 had outstanding:

$15,685,400 of common stock (R. 31).

$42,518,000 of first-mortgage bonds (R. 30).

$10,000,000 of second-mortgage bonds (R. 31).

After the reorganization of 1908–09, Company No. 2 had outstanding:

$21,521,400 of common stock (R. 31–32).

$10,000,000 of preferred stock (R. 31).

$42,518,000 of first-mortgage bonds (R. 30).

The stock of Company No. 2 was distributed as follows:

The holders of the old capital stock upon payment of 40 per cent of its par value received the new common stock in

287 U.S. 410; *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S. 415, and *Planters Cotton Oil Co.* v. *Hopkins*, 286 U.S. 332, no argument is required to show that in its earlier decision the court below erred in disregarding the separate corporate entity of the respondent in order to give it a deduction denied by the regulations. The earlier decision in this respect was based principally upon decisions of this Court in *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330; *Gulf Oil Corporation* v. *Lewellyn*, 248 U.S. 71, and several other cases decided by this Court at about the same time in which, under particular circumstances, separate corporate entities were disregarded. As appears from the decision in *Burnet* v. *Commonwealth Improvement Co., supra*, those cases are not to be regarded as laying down any general rule applicable to tax cases, and, in view of the later decisions of this

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exchange, share for share, to the extent of $15,685,400 (R. 31–32). Holders of the old second-mortgage bonds received the $10,000,000 preferred stock and in addition $836,000 par value of common stock in payment of overdue interest coupons (R. 31). These bondholders were also permitted to purchase $5,000,000 par value of common stock upon the payment of 40 per cent thereof (R. 31). The first-mortgage bonds of Company No. 2 were the obligations of Company No. 1 which had been assumed by Company No. 2 (R. 30). The preferred stock had equal voting rights with the common, and thus it will be seen that the control of the business had passed from the common stockholders of the old company to the second-mortgage bondholders. In addition to the $42,518,000 first-mortgage bonds already outstanding, Company No. 2 thereafter sold $4,115,000 more at a discount of $617,100. These were issued in the name of Company No. 1 and were identical in every way with the bonds of the

Court, we believe that the effort, in the eralier decision of the court below, to disregard form in a search for an intangible substance was clearly unjustified.

It has been held in several cases that new taxable entities succeeding to the assets and liabilities of predecessors do not acquire their right to deductions. See *Athol Manufacturing Co.* v. *Commissioner,* 54 F. (2d) 230 (C.C.A. 1st); *The Maytag Co.* v. *Commissioner,* 17 B.T.A. 182; cf. *Planters Cotton Oil Co.* v. *Hopkins,* 286 U.S. 332; *Woolford Realty Co.* v. *Rose,* 286 U.S. 319. Since the

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same series which had been previously sold by Company No. 1 and were secured by the same mortgage, dated October 1, 1902 (R. 30).

After the reorganization of 1917, Company No. 3, the respondent, had the following outstanding:

$50,000,000 of common stock (R. 32).

$17,760,400 of first preferred stock (R. 32).

$10,000,000 of second preferred stock (R. 32).

$46,633,000 of first-mortgage bonds (R. 30).

This common stock was acquired by exchanging, share for share, the common stock of Company No. 2 (R. 32), which in 1917 had outstanding $49,429,230 of common stock. (Original Exhibit A, p. 14.) The second preferred stock was issued to the holders of preferred stock of Company No. 2 (R. 32). Part of the first preferred stock was issued to the holders of certain secured promissory notes of Company No. 2, which matured in 1915, and which, with accrued interest, equaled the amount of the first preferred stock which was issued (R. 32–33). The remainder of the first preferred stock was subscribed for at par by the stockholders of Company No. 2 (R. 33). The bonds of Company No. 3 consisted of the $42,518,000 issued by Company No. 1, and the additional $4,115,000 issued by Company No. 2, all of which were assumed by Company No. 3. All classes of stock had equal voting rights (R. 32).

petitioner sold no bonds at a discount, it was not entitled through succession to a deduction for a discount incurred by others. When the property of its immediate predecessor was acquired by petitioner, its predecessor would apparently have been entitled to deduct the remaining amortized discount as a loss (*Metropolitan Properties Corporation*, 24 B.T.A. 220); but it did not and could not pass on to respondent its right to the deduction, since the regulations recognized no such process of succession.

We believe that the court below in its earlier decision also erred in concluding that the respondent was entitled to the deduction because it had assumed liabilities and acquired assets of the predecessor corporations. In the earlier case it seems to have been considered that the issuing corporations had amortized the bond discount on their books, but the stipulation in the present cases is to the contrary (R. 31). The respondent assumed the liability on the bonds at their full face value. There seems to be no possible basis for the view that this obligation was in any way affected by the fact that the issuing corporations had received less than the face amount of the bonds because they had been issued at a discount. The respondent was not a party to any loss sustained upon the issuance of the bonds. It would seem that the only way that the respondent could have received any advantage from the action of its predecessors at the time the bonds were issued would have been in connection with the terms

upon which it took over its predecessors' assets. The fact that the bondholders may receive at maturity more than they paid for the bonds in the first instance does not suggest that respondent has suffered a loss because of the original discount. There is nothing to show that the value of mortgaged assets acquired from its predecessors was not, at the date of acquisition, equal to the full face value of the bonds, and, even if they had not been, the respondent took over a definite liability and was not privy to any loss which occurred before it came into existence.

The Board of Tax Appeals has declined to follow the earlier decision of the court below and has held that similar new corporations are not entitled to amortize discount by reason of assuming the liabilities of the issuing corporation. *Missouri Pacific R.R. Co.* v. *Commissioner,* 22 B.T.A. 267; *Southern Railway Co.* v. *Commissioner,* 27 B.T.A. ——.

CONCLUSION

The decision of the court below is erroneous and should be reversed.

Respectfully submitted.

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MAY 1933.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * *.

[The same provision appears in Section 234 (a) (2) of the Revenue Acts of 1921 (c. 136, 42 Stat. 227, 254) and 1924 (c. 234, 43 Stat. 253, 283; U.S.C., Title 26, Sec. 986).]

Treasury Department Regulations 45 (1920 Edition):

> ART. 544. *Sale and retirement of corporate bonds.*—* * *.
>
> * * * * *
>
> (3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any

amount of discount not yet deducted) is a deductible expense for the taxable year. * * *.

ART. 563. *Sale of capital stock, bonds, and capital assets.*—* * *. If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid * * *.

[The same provisions appear in Article 545 (a) (3) and Article 563 of Treasury Department Regulations 62 and 65.]

U. S. GOVERNMENT PRINTING OFFICE: 1939

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 842.

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE,
PETITIONER,

versus

WESTERN MARYLAND RAILWAY COMPANY,
RESPONDENT.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

EUGENE S. WILLIAMS,
WILLIAM C. PURNELL,
Attorneys for Respondent.

The Daily Record Co. Print, Baltimore.

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versus

WESTERN MARYLAND RAILWAY COMPANY,
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BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

Respondent prays that certiorari be denied in the above entitled cause for reasons hereinafter presented.

OPINIONS BELOW

The opinion of the United States District Court for the District of Maryland (R. 38) is reported in 53 Fed. (2d) 211, and the affirming opinion of the Circuit Court of Appeals for the Fourth Circuit (R. 52) is reported in 62 Fed. (2d) 933. The opinion of the latter court in the previous case, by reason of which respondent contends the present case is *res judicata*, is reported in 33 Fed. (2d) 265.

QUESTIONS TO BE DETERMINED.

1. Whether the circumstances here presented are such as to necessitate or justify further pronouncement by this Court of the applicability of the principle of *res judicata* in tax litigation.

2. Whether, if the present case is not controlled by the principle of *res judicata*, respondent is entitled, in computing its taxable income for the years 1920 to 1925, to deduct the amortized discount at which certain bonds, the payment of which it has assumed, were sold by its predecessor company.

SUMMARY OF ARGUMENT.

I. There is no reason or authority for denying effect to the principle of *res judicata* in tax litigation.

(a) That the rule is applicable to tax cases, if the matter in issue or point of controversy is the same, though involving taxes for years subsequent to the one adjudicated, has been settled by this Court. Here the question is the same as that previously determined, to wit, the effect of the reorganization of respondent's predecessors upon its claim to the deduction.

(b) The distinction between the instant case and *United States v. Stone & Downer Co.*, 274 U. S. 225, is that which was drawn by this Court in distinguishing *New Orleans v. Citizens Bank of Louisiana*, 167 U. S. 371.

(c) The suggested difference between the evidence in this and the former case is immaterial, because the matter in issue remains unchanged.

That the parties are identical has been determined by this Court.

(d) *Res judicata* is not to be denied application in tax cases merely because the successful litigant may alone benefit. The contrary conclusion would defeat the principle in most, if not all, instances. Nor is the principle affected by petitioner's reasoning that if the decision in the former case in respondent's favor is to permanently stand discrimination would result against a taxpayer claiming a similar right, if his claim is denied by the courts. If this be true, the situation was created by the government when it decided not to seek review by this Court of the former case. Petitioner cannot reasonably expect to determine the rights of all taxpayers in a single suit in which only one may be a party.

II. The present controversy is *res judicata* and not open to review on the merits. This is true, even if the prior adjudication was based upon an error of law or fact. Viewed on the merits, however, respondent is entitled to the deduction, for, having assumed the payment of the bonds, respondent stands in the place of its predecessors with respect to such bonds and has the same right to deduct the amortized discount.

ARGUMENT.

I.

THERE IS NO REASON OR AUTHORITY FOR DENYING EFFECT TO THE PRINCIPLE OF RES JUDICATA IN TAX LITIGATION.

Petitioner's contentions are below answered in the order in which they are presented.

(a) Petitioner contends that because the revenue acts give a separate right of action to collect each year's taxes, the principle of *res judicata* cannot be applied to defeat full determination of the amount of taxes due each

year. The substance of the contention is that the government has a fresh start each year.

This Court has expressly held *res judicata* applicable in tax litigation where the demand in suit arose upon an assessment for a subsequent year. In the leading case of *New Orleans v. Citizens Bank of Louisiana*, 167 U. S. 371, this Court, in deciding that the statutory exemption of a bank's capital and stock determined for one year was *res judicata* on the question of the exemption of the same capital and stock in a subsequent year, said:

> "The proposition that because a suit for a tax of one year is a different demand from the suit for a tax for another, therefore *res judicata* cannot apply, whilst admitting in form the principle of the things adjudged, in reality substantially denies and destroys it. The estoppel resulting from the thing adjudged does not depend upon whether there is the same demand in both cases, but exists, even although there be different demands, when the question upon which the recovery of the second demand depends has under identical circumstances and conditions been previously concluded by a judgment between the parties or their privies. * * *
>
> "It follows then, that the mere fact that the demand in this case is for a tax for one year, and the demands in the adjudged cases were for taxes for other years, does not prevent the operation of the thing adjudged, if in the prior cases the question of exemption was necessarily presented and determined upon identically the same facts upon which the right of exemption is now claimed." (P. 396, 398).

Accord: *Gunter v. Atlantic Coast Line R. Co.*, 200 U. S. 273; cf. *Baldwin v. Maryland*, 179 U. S. 220; *Bank of Kentucky v. Stone*, 174 U. S. 799, affirming without opinion,

Judge Taft in *Bank of Kentucky v. Stone*, 88 Fed. 383. And see *Hoystead v. Commissioner of Taxation*, (1926) A. C. 155, where the application of *res judicata* by the House of Lords is precisely that now contended for by respondent.

The general rule as stated in *Southern Pacific R. R. Co. v. United States*, 168 U. S. 1, also banishes the theory advanced by petitioner that the question is preserved for subsequent litigation between the parties because the income tax laws create a different cause of action for each succeeding year:

> "The general principle announced in numerous cases is that a right, question, or fact distinctly put in issue and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; *and even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established, so long as the judgment in the first suit remains unmodified.*" (Italics supplied.) (P. 49).

Accord: *United States v. California Bridge & Construction Co.*, 245 U. S. 337; *Cromwell v. Sac County*, 94 U. S. 351.

The question now in issue is the effect of the reorganization of respondent's predecessors upon the right of respondent to deduct the amortized items of discount involved in the sale of such bonds. It is precisely this question which was specifically in issue on the previous appeal, and which was determined in favor of respondent. (*Western Maryland Railway Co. v. Commissioner*, 33 Fed. (2d) 695, 696). That decision was not further ap-

pealed by the Commissioner to this Court, as he had a right to do if he deemed it erroneous. The authorities cited above amply sustain respondent's right to invoke *res judicata* to protect the rights it secured by that judgment.

There is nothing in *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, to the contrary. It was simply pointed out in that case, as we understand it, that fixed periods of accounting for income are applicable under the revenue acts, and that making these periods of annual duration was not an arbitrary provision.

United States v. Ness, 245 U. S. 319, *Maney v. United States*, 278 U. S. 17, and *Tutun v. United States*, 270 U. S. 568, establish no general principle, as contended for by petitioner, limiting the application of *res judicata* where statutes provide cumulative remedies. They determine merely the narrow point of the effect of Sections 11 and 15 of the Naturalization Act of June 29, 1906.

(b) There is clearly no conflict with *United States v. Stone & Downer Co.*, 274 U. S. 225, because that case deals with the peculiar considerations applicable to the Court of Customs Appeals, and as is pointed out in the opinion, "These are the reasons, too, why the principle laid down by this court in the decision already referred to, in *New Orleans v. Citizens Bank*, 167 U. S. 371, should not apply or control." (P. 237).

(c) The existence of differences of fact between this case and the prior one, as suggested by petitioner, is of no moment in determining the applicability of *res judicata*. The nature of the "matters in issue or points controverted" (*Cromwell v. Sac County*, 94 U. S. 351, 353), is not changed in any particular, since, as pointed out below,

this evidence merely "shows more clearly the gap between the present corporation and the one which issued the bonds" (R. 55). The question for decision which has been heretofore stated remains thus unchanged by the enlargement of the facts which underlie it. The language in *Baltimore Steamship Co. v. Phillips*, 274 U. S. 316, 321, accurately describes the present situation:

> "*A cause of action does not consist of facts, but of the unlawful violation of a right which the facts show.* The number and variety of the facts alleged do not establish more than one cause of action so long as their result, whether they be considered severally or in combination, is the violation of but one right by a single legal wrong. The mere multiplication of grounds of negligence alleged as causing the same injury does not result in multiplying the causes of action. 'The facts are merely the means, and not the end. They do not constitute the cause of action, but they show its existence by making the wrong appear. 'The *thing*, therefore, which in contemplation of law as its *cause*, becomes a ground for action, is not the group of *facts* alleged in the declaration, bill, or indictment, *but the result of these in a legal wrong, the existence of which, if true, they conclusively evince.*'" Chobanian v. Washburn Wire Co., 33 R. I. 289, 302, 80 Atl. 394, Ann. Cas. 1913D, 730." (Italics in first sentence ours.)

Cf. *Grubb v. Public Utilities Commission*, 281 U. S. 470, 479; *Hoystead v. Commissioner of Taxation, supra.*

Petitioner suggests that the parties in two of the present cases (Law Nos. 4172 and 4469, R. 1) and the former case are not identical. This is based upon the ground that in these suits the Collector is made the defendant, while in the former appeal the proceedings were against the Commissioner. Any doubt of the sufficiency of iden-

tity of the parties, in so far as the present discussion is concerned, seems dispelled by *Old Colony Trust Company v. Commissioner*, 279 U. S. 716, where this Court, in dealing with the difficulty that under Sections 283(b) and 284(d) of the Revenue Act of 1926, suits in court could still be brought in cases instituted before the Board prior to the 1926 Act, while the latter act at the same time made proceedings from the Board exclusive, said:

> "But the apparent conflict in such cases can be easily resolved by the use of the principles of res judicata. If both remedies are pursued, the one in a district court for refund, and the other on a petition for review in the circuit court of appeals, the judgment which is first rendered will then put an end to the questions involved and in effect make all proceedings in the other court of no avail. Whichever judgment is first in time is necessarily final to the extent to which it becomes a judgment." (P. 728).

While the Collector or the United States is necessarily the defendant in a proceeding in the district court to recover taxes, and the Commissioner is necessarily the defendant in cases appealed from the Board of Tax Appeals, this Court seems clearly to have regarded such defendants as identical. The reasons stated for the like conclusions reached in the lower courts, in the cases cited by petitioner, are clearly sound.*

(d) Petitioner's assertion of the necessity for an unfettered application of tax decisions in the administration of tax laws is, of course, a demand for a complete denial of *res judicata* in income tax cases. It is the claim of a right to force respondent to litigate its tax liability

* The Collector is subjected to suits for refund simply because of his official agency for the United States, so that while a judgment against him individually as agent may well not bind the principal, the converse is by no means true. See *Second National Bank of Saginaw v. Woodworth*, (D. C. Mich. 1931) 54 Fed. (2d) 672.

on these bonds for each year until their maturity in 1952. That the possibility of repeated litigation exists is apparent from the record in this case.

Respondent obtains through *res judicata* no unfair advantage such as petitioner appears to imply. It secures only the results of thorough litigation. If the government was of the opinion that the former decision was erroneous it could have sought review by this Court. So in *Reed v. Allen*, 286 U. S. 191, the failure to appeal from a judgment founded on a prior judgment subsequently reversed, was held not to justify a denial of the application of *res judicata* to the second judgment, simply because of the hardship involved. In the course of that opinion it is said:

> "The predicament in which respondent finds himself is of his own making, the result of an utter failure to follow the course which the decision of this court in Butler v. Eaton, supra, had plainly pointed out. Having so failed, we cannot be expected, for his sole relief, to upset the general and well established doctrine of *res judicata*, conceived in the light of the maxim that the interest of the state requires that there be an end to litigation—a maxim which comports with common sense as well as public policy. And the mischief which would follow the establishment of a precedent for so disregarding this salutary doctrine against prolonging strife would be greater than the benefit which would result from relieving some case of individual hardship." (P. 198-199).

There is no valid reason why these considerations are not equally applicable to the government in the assertion of tax demands. Taxpayers are unquestionably entitled to rely upon the sanctity of tax judgments, to no less extent than those recovered in any other civil proceeding. Concededly the government

is not to be unduly hampered in administering the revenue laws, but the government is not immune to most of the well established rules of law, including *res judicata*. Respondent would certainly be bound by the former decision if it had been adverse, and the equal administration of the revenue laws does not require that the government be differently treated, even if that could be done legally. The common principle that the taxpayer is entitled to the benefit of any doubts arising in the construction of tax laws is wholly inconsistent with petitioner's proposal which would deny the benefit of a construction secured.

Nor does any good reason appear why the government should be permitted to litigate a question in a single case such as *Handy & Harman v. Burnet*, 284 U. S. 136, referred to by petitioner, and yet expect its conclusions to apply against other taxpayers who have raised the same question in other suits, but whose cases have been allowed to terminate adversely to the government. It is obviously not necessary to bring to this Court every case which involves the same point of law, though there are numerous instances where the government has deemed a point to be of sufficient importance to carry several cases involving such point to this Court for decision at the same time or in the same term.* Nor, on the other hand, is the government at liberty to forego its rights as to one taxpayer on the theory that the determination of another's rights will necessarily settle those of the former as well.

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* See for example the cases decided at the last term involving the validity of Section 302(c) of the Revenue Act of 1926. *Heiner v. Donnan*, decided March 21, 1932, 285 U. S. 312; *Handy v. Delaware Trust Co.*, March 21, 1932, 285 U. S. 352; *Anderson v. Guinzburg*, certiorari denied March 28, 1932, 285 U. S. 553; *White v. Hall*, certiorari denied March 28, 1932, 285 U. S. 553.

To petitioner's assertion that the importance of *res judicata* in tax cases is such as to require a review in the present instance it may be said that this general question has been repeatedly treated by this Court and may be now regarded as settled. *New Orleans v. Citizens Bank*, supra; *United States v. Stone & Downer*, supra; *Old Colony Trust Company v. Commissioner*, supra.

II.

THE MERITS OF THE PRESENT CASE ARE NOT OPEN TO REVIEW.

Respondent denies that the right to deduct amortized bond discount is lost by a change in identity of the corporation issuing the bonds. The right to deduct the discount arises from the fact that respondent took over the property of its predecessor and assumed payment of the bonds. Respondent, therefore, stands in place of the issuing company, with respect to the bonds and the discount, and is equally entitled to the deduction.

In any event, the question is not open to review. "But a *fact, question,* or right distinctly adjudged in the original action cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law." *United States v. Moser*, 266 U. S. 236, 242. *American Express Co. v. Mullins*, 212 U. S. 311; *Reed v. Allen, supra; Vinson v. Graham*, 44 Fed. (2d) 772.

Respectfully submitted,

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RESPONDENT'S BRIEF

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CHARLES ELMORE CR
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v.

WESTERN MARYLAND RAILWAY COMPANY,

Respondent.

BRIEF FOR THE RESPONDENT.

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The Daily Record Co. Print, Baltimore.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 842.

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE,

Petitioner,

v.

WESTERN MARYLAND RAILWAY COMPANY,

Respondent.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the United States District Court for the District of Maryland (Record p. 38) is reported in 53 Fed. (2d) 211, and the affirming opinion of the Circuit Court of Appeals for the Fourth Circuit (Record p. 52) is reported in 62 Fed. (2d) 933. The opinion of the latter court in *Western Maryland Railway Company v. Commissioner,* by reason of which the respondent contends the present case is *res judicata,* is reported in 33 Fed. (2d) 695.

STATEMENT.

The essential facts are sufficiently set forth in the brief for the petitioner.

QUESTIONS PRESENTED.

1. Is not the decision of the Circuit Court of Appeals for the Fourth Circuit in *Western Maryland Railway Company v. Commissioner res judicata* of the present controversy?

2. Is not the respondent entitled, in any event, in computing its taxable income for the years 1920 to 1925, to deduct from gross income the annual proportion of the discount at which certain bonds were sold by its predecessor companies, the payment of which it has assumed?

3. If the respondent is not entitled to deduct the discount arising from the sale of a portion of the bonds prior to the 1910 reorganization, is it not entitled to deduct the discount arising from the sale of the remaining portion of the bonds after that reorganization?

SUMMARY OF ARGUMENT.

I.

The issue in this case has already been adjudicated in *Western Maryland Railway Company v. Commissioner*, 33 Fed. (2d) 695. The principle of *res judicata* is, therefore, applicable. The contention of the petitioner that the revenue acts preclude the application of that principle in income tax cases, or that public policy so requires, is untenable.

It was determined in the former case that the respondent, in computing its annual income tax liability, has the right to deduct the amortized discount at which certain bonds were sold by its predecessor companies. The fact that different tax years are now involved is of no consequence, the question of the respondent's right to amortize the discount over the life of the bonds, for income tax purposes, remaining the same.

This Court has repeatedly held that the principle of *res judicata* is applicable in tax litigation. The reason for the principle applies equally here.

Neither the language of the revenue acts nor the reason for allowing deductions for discount supports the petitioner's contention that the revenue acts contemplate that the principle be not applied in income tax cases. Nor is the contention valid that public policy demands that the principle be not applied in this character of litigation.

II.

There is no such difference of parties as renders inapplicable the principle of *res judicata.*

The decisions that a judgment against a collector, being personal in its nature, does not bind the Government are not authority against the proposition that a prior judgment adverse to the Government may not bind a collector. Different considerations apply in the latter instance and the reasons for the application of the rule exist.

III.

The revenue acts and the regulations entitle the respondent to the deductions, although the bonds were issued by its predecessors.

Admittedly, the respondent's predecessors would have been entitled to the deduction if there had been no corporate change. The reason for allowing the deduction is that the discount represents, in part, the cost of the borrowed money. The respondent, having succeeded to the property and assumed the payment of the bonds and interest, occupies the same position with respect to the

discount, the bonds and the property as did the issuing company, and is equally entitled to amortize the discount.

IV.

Whether or not the respondent is entitled to deduct for the discount arising from the sale of a portion of the bonds prior to the 1910 reorganization, it is entitled to deduct for the discount at which the remaining bonds were sold after that reorganization by The Western Maryland Railway Company, because that company and the respondent are, to all intents and purposes, one and the same. This is true because the consolidation merely changed the corporate form of the respondent's existence.

ARGUMENT.

I.

THE ISSUE IN THIS CASE WAS CONCLUSIVELY SETTLED BY THE FORMER DECISION. PETITIONER'S CONTENTION THAT THE REVENUE ACTS PRECLUDE THE APPLICATION OF THE PRINCIPLE OF RES JUDICATA, AND THAT PUBLIC POLICY REQUIRES THAT THE PRINCIPLE BE NOT APPLIED IN INCOME TAX CASES, IS UNTENABLE.

The question decided by the Circuit Court of Appeals in the former case was whether the respondent, in computing its annual income tax liability, has the right to deduct the amortized discount at which certain bonds were sold by its predecessor companies. It is that question which the Government again raises. The years are different, but the issue is the same, as the opinion of the court below clearly shows. This is also shown by the record and pleadings in the former case (Exhibit D, p. 25, par. (5)), and the following from the Government's brief in the present case (p. 10):

> "The sole question is whether the determination of the issue of the respondent's right to deduct amortized discount on the bonds sold by its predecessors in the earlier decision necessarily constitutes an estoppel by judgment which precludes a reconsideration of the question in this case."

It may be said at the outset that the decisions of this Court have settled that the principle of *res judicata* is applicable in tax litigation. *City of New Orleans v. Citizens Bank of Louisiana*, 167 U. S. 371; *Stone v. Deposit Bank*, 174 U. S. 800; *Deposit Bank v. Frankfort*, 191 U. S. 499; *Baldwin v. Maryland*, 179 U. S. 220; *Gunter v. Atlantic Coast Line Ry. Co.*, 200 U. S. 273. The principle was also expressly recognized in *United States v. Stone & Downer Co.*, 274 U. S. 225, and *Old Colony Trust Company v. Commissioner*, 279 U. S. 716, 728. The House of Lords has applied the principle in tax litigation. *Hoystead v. Commissioner of Taxation*, 1926 A. C. 155. In the first group of cases cited and in *Hoystead v. Commissioner of Taxation*, the fact that the subsequent proceeding involved taxes for a later year or years than were involved in the prior adjudication did not prevent the application of the principle. It was said in *City of New Orleans v. Citizens Bank of Louisiana* (pp. 396, 398):

> "The estoppel resulting from the thing adjudged does not depend upon whether there is the same demand in both cases, but exists, even although there be different demands, when the question upon which the recovery of the second demand depends has under identical circumstances and conditions been previously concluded by a judgment between the parties or their privies. * * *
>
> "It follows, then, that the mere fact that the demand in this case is for a tax for one year, and the demand in the adjudged cases were for taxes for other years, does not prevent the operation of the

> thing adjudged, if in the prior cases the question of exemption was necessarily presented and determined upon identically the same facts upon which the right of exemption is now claimed."

It is true that in no case has this Court dealt specifically with the applicability of the principle of estoppel by judgment in litigation arising under the federal income tax laws. The fundamental reason for the principle is apparent. But for the rule "nothing would be settled, and the judgment, unreversed, instead of having the effect of forever settling the rights of the parties, would be but an idle ceremony." *Deposit Bank v. Frankfort, supra,* (p. 511). The doctrine is as applicable to controversies between the Government and an individual as to other controversies. *United States v. Moser,* 266 U. S. 236; *Southern Pacific Ry. Co. v. United States,* 168 U. S. 1, 49.

It is the Government's contention, however, that the revenue acts disclose an intention, and the public policy demands, that the principle shall not apply in income tax litigation.

It may be noted in passing that the Government has previously litigated in this Court an income tax case involving the principle of estoppel by judgment without suggesting, in so far as the opinion discloses, that any reasons of public policy demand that the principle be not applied in such cases, but tried the case upon the narrow question of whether there was identity of parties. *Bankers Pocahontas Coal Co. v. Commissioner,* No. 104, October Term, 1932. Indeed, in cases before the Board of Tax Appeals the Government has, on more than one occasion, successfully contended for the application of *res judicata* in just such instances as is

now urged there is a public interest which forbids its application. *Appeal of Gilliam,* 2 B. T. A. 272; *Appeal of Mary Haller,* 26 B. T. A. 395. While it is stated in the Government's brief (foot-note, p. 17) that the Government is not arguing for the application of the doctrine in its brief in the latter case now on appeal in the District of Columbia, the fact that the Government has argued for the application of the principle on various occasions would seem to indicate, at least, that it has not heretofore regarded that the public interest was being jeopardized.

There is next considered the two propositions advanced by the Government, first, that the revenue acts have by implication abolished the principle of *res judicata,* and, second, that public policy requires that the principle be not applied in federal income tax cases. We contend that neither of these propositions is tenable.

THE REVENUE ACTS HAVE NOT ABOLISHED THE PRINCIPLE OF RES JUDICATA.

The revenue acts involved nowhere expressly declare any intention to repudiate the general principle of estoppel by judgment. Recognizing this fact, the petitioner asks the Court to read such an intention into those acts. Certain unrelated provisions of the acts are relied upon in justification. First it is pointed out that the liability under the revenue acts is an annually recurring one which is enforceable in separate successive proceedings. But the same may be said of taxes generally. The fact was regarded as immaterial by this Court in *City of New Orleans v. Citizens Bank of Louisiana, supra,* and other cases cited above.

The provision of the statute is cited that where a court decision changes a Treasury regulation such decision is to be given retroactive effect. The apparent purpose of

that provision is to require that if the regulation has been incorrectly applied in previous unlitigated cases the mistake shall be corrected. If this provision affords any indication of the statutory intent it is that Congress did not intend to veto, but rather to give full recognition to, court adjudication.

The provision of the statute authorizing closing agreements between taxpayers and the Government for particular years is cited, together with a decision of the Board of Tax Appeals in effect that facts set forth in such agreements can be contradicted subsequently in disputes involving other years. The suggestion seems to be that, as the statute provides in such a situation that there shall be no *estoppel by agreement*, it must also have intended that there be no *estoppel by judgment*. It would have been equally simple to provide that there shall be no estoppel by judgment if Congress had so intended. Again, it is clear that the reasons for applying the principle in the case of a prior judgment have no application to a voluntary agreement between parties which they themselves intended should apply to one year only.

Lastly, it is cited in this connection that the statute gives the Board of Tax Appeals the power to inquire into facts relating to preceding years, in order to determine the correct liability for a subsequent year. The purpose of this provision, it would seem, is simply to enable the Board to effectively accomplish its object of ascertaining the correct liability for the year involved. This, in some instances, would necessitate inquiry into preceding years in order that the Board may have before it all relevant facts in determining the true tax liability.

THERE IS NO POLICY REQUIRING REPUDIATION OF THE PRINCIPLE OF ESTOPPEL BY JUDGMENT IN FEDERAL INCOME TAX CASES.

It is next argued by the Government that, as each year creates a new tax obligation, "serious consequences would result" if the rule of estoppel by judgment is applied to income tax cases relating to years not involved in the prior adjudication; that discrimination may result between taxpayers, and that a sound policy, therefore, requires that the principle be repudiated in this character of litigation. Reliance is principally placed upon *United States v. Stone & Downer Co., supra.* The decision related to the binding effect of a prior classification of imports by the court of customs appeals and was expressly intended not as a precedent in tax litigation. Early in the opinion it is stated (p. 230):

> "It is settled in this court that the general rule by which a judgment estops the parties in future litigation between them, to question either a fact or a point of law necessary to the first judgment and adjudicated therein, applies to cases of taxation as well as to other subjects of litigation."

The Court then pointed out that there is a clear distinction between an official classification of imports for duty and a court adjudication in tax cases; that the court of customs appeals made its own rules and must necessarily determine, as a practical matter, what should be the conclusive effect of its own judgment in subsequent proceedings involving the various classifications by it, and that from the beginning that court had declined to be bound by its previous decisions. This Court held that it would not, in view of the peculiar problems inherent in the classification of imports, interfere with the sound policy adopted by the court of customs appeals in not being bound by its previous decisions. The case can in no sense, therefore, be said to furnish a precedent, as suggested by

petitioner, for overthrowing the principle in income tax cases.

A number of cases are cited by the petitioner to support its contention that discrimination will result. They hardly serve the purpose. *Handy & Harman v. Burnet*, 284 U. S. 136, is cited to show that discrimination will result if the decision of this Court is not to apply equally to all similarly situated, including any who may have obtained prior judgments contrary to the decision of this Court. The argument is purely conjectural and does not undertake to cite any instance where a taxpayer procured a prior favorable decision in a lower court and, as a result, may enjoy benefits from filing consolidated returns under conditions falling short of the statutory requirements, as construed by this Court in the case cited.

The petitioner also cites *Burnet v. Jergins Trust*, No. 541, October Term, 1932, where this Court held that a lessee of certain municipal property was not immune from the federal tax upon the profits derived from the leased premises. The court below had decided the contrary. It is argued that the taxpayer would have perpetually enjoyed the benefits of the lower court's decision if the decision had not been appealed from, and the correct rule had not been laid down by this Court until a later case. Here, as in *Handy & Harman v. Burnet, supra*, the Government relies on pure conjecture. Speculation is indulged in as to what might have happened if the Government had fallen short of its duty to have a timely adjudication of the issue,—presumably an important one.

Several cases involving the right of certain partners to allowances for depletion of their respective interests in oil and gas leases are cited. *Waller v. Commissioner*, 40 Fed. (2d) 892; *Herold v. Commissioner*, 42 Fed. (2d)

942; *Palmer v. Bender*, 287 U. S. 551. The first two cases were decided adversely, and the third favorably, to the taxpayer. It is contended that, as a result of these decisions, several members of the same partnership would in future be taxed upon different bases, if the doctrine of *res judicata* were applied. There is nothing to show that the various litigants are not being taxed upon different bases. The situation, in any event, seems to be unique, for none of the other cases cited on behalf of the Government discloses a similar situation.

The case of *Burnet v. Logan*, 283 U. S. 404, and *Hitchcock v. Commissioner*, 44 Fed. (2d) 756, are merely other instances of possible disparity in taxation if the taxpayer in the second case mentioned had not pursued his legal remedy to its full extent and obtained a reversal of the adverse decision below.

If it be true, however, that an occasional instance of discrimination might result from the application of the doctrine of *res judicata*, can that be sufficient to justify the abolition of the principle in federal income tax litigation? Congress is well aware that the principle of estoppel by judgment is firmly established in the jurisprudence of this country, and if it intended that that principle be not applicable in federal tax litigation it would, doubtless, have expressly so enacted, and not left its intention so concealed in the statute that "nothing but the exigency of a hard case and ingenuity and study of an acute and powerful intellect would discover" it. *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 370.

The petitioner complains that the former decision was based on an inadequate or incorrect record, and asserts that otherwise "a contrary result would in all probability have been reached." Even if correct, the complaint

would be insufficient to defeat estoppel. In *United States v. Moser, supra,* it was said (p. 242):

> "But a *fact, question,* or *right* distinctly adjudged in the original action cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law."

To the same effect or *Reed v. Allen,* 286 U. S. 191; *American Express Co. v. Mullens,* 212 U. S. 351.

Despite the inadequacy of the complaint it may, if unanswered, lead to unwarranted inferences, and we, therefore, reply to it.

First, it is said that "it was erroneously stipulated that Company No. 1 'may be taken as identical' with Company No. 2, and the Circuit Court of Appeals accordingly treated the case as though the bonds had been issued by Company No. 2 under its own mortgage." The reason for that stipulation is readily understood when it is remembered that the deduction was disallowed and the case tried on the contention that the regulations, infra, p. 21, allow deductions for discount only to the company which issues the bonds. That being the defense relied upon in the case, it was appropriate to confine the stipulation to such facts as would adequately present the defense. That that issue was adequately presented and comprehensively considered is apparent from the following language of the court:

> "In the second place, we think that, irrespective of the practical identity of the old and new corporations, petitioner is entitled to the deduction claimed because of having taken over the assets and assumed the liabilities of the old corporation which was unquestionably entitled to it. Among the liabilities of the old corporation as shown by its books was the amount set up as bond discount, against which was charged each year an amortized portion thereof. In taking over the liabilities and assets, the new cor-

> poration took the place of the old as to both of these items. As has been said, bond discount is really deferred interest payable at the maturity of the bonds. When, therefore, the new corporation assumed the obligations of the old, its agreement to pay the bonds at maturity embraced necessarily the agreement to pay this deferred interest, which is included in the face of the bonds. As the new corporation is bound to pay this, there is no reason why it should not amortize it in the same way as the old corporation." (33 Fed. (2d) 695, 698).

It seems clear, therefore, that the former decision was not affected by the absence of the details of the 1910 reorganization. The trial court, in disposing of this same contention, pointed out that, although it was not particularly stressed, "the earlier reorganization was before the Board of Tax Appeals and the appellate court in the stipulation of facts and in the pleadings." And, after quoting the above language of the Circuit Court of Appeals in the prior case observed, as we believe, correctly (Record, p. 43):

> "If the foregoing reasoning is to be given proper interpretation, it must be taken as being just as applicable to a plurality, or series of consolidations, as it is to a single one, provided the same essential elements are always successively present, namely, acquisition by the successor corporation of the particular assets and liabilities of its predecessor. If these do exist, then the precise manner of acquisition is not, as the Government contends, material. * * *
>
> "Thus we must conclude that further litigation of the question here raised is precluded by the decision of the Circuit Court of Appeals, because the same material facts were before that court."

The second error, but for which it is averred that the court would "in all probability" have reached a contrary

conclusion, is "that the bond discount in question had not been amortized on the books of either Company No. 1 or Company No. 2, although the Circuit Court of Appeals had assumed the contrary in the earlier decision." The above quotation from the court's opinion leaves little room for the supposition that this assumption had any material bearing upon its conclusion. Nor is it to be taken for granted that the court was not fully aware of the immateriality of how the discount was treated on the books. Mere failure of book entries cannot determine the question of taxability. The Board of Tax Appeals has repeatedly so held, and the Government has, as we understand, adopted the view. Regulations 62, Art. 848; O. D. 111, C. B. 1919, p. 224. *Chicago, Rock Island & Pacific R. R. Co. v. Commissioner,* 13 B. T. A. 998; *Kansas City Sou. Ry. Co. v. Commissioner,* 16 B. T. A. 665. This Court sanctioned the theory in *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179, and in its repeated decisions that substance and not form is to prevail in determining tax liability. *Weiss v. Stearn,* 265 U. S. 242; *United States v. Phellis,* 257 U. S. 156; *Eisner v. Macomber,* 252 U. S. 189.

It would seem, therefore, that there is little to support the averment that "a contrary conclusion would in all probability have been reached" if the details of the 1910 reorganization had been embodied in the stipulation of facts, or if the court had not assumed that the discount had, in fact, been amortized on the books.

The petitioner seeks to distinguish the cases in which this Court has applied the principle to tax litigation, on the ground that the decisions in "all but one" (*Baldwin v. Maryland, supra*) of those cases have allegedly affected only a single taxpayer. An extended and ingenious argument is advanced to support the contention with respect to the decision of this Court in *Deposit*

Bank v. Frankfort, 191 U. S. 499. That case is a striking example of the extent to which this Court has gone in applying the principle, and deserves further reference here.

As the reports of this Court disclose, a great deal of litigation grew out of a Kentucky statute known as the Hewitt act, which provided a certain basis of taxation for banks accepting the provisions of the act. Afterwards, in 1892, a statute was passed creating additional taxes, which the banks contested on the ground that the basis of taxation fixed by the Hewitt act was contractual and could not be impaired by later legislation. This contention was sustained by the court of appeals of Kentucky in the first *Bank Tax Cases,* 31 S. W. 1013, but that decision was overruled in the second *Bank Tax Cases,* 39 S. W. 1030. The Bank of Frankfort had been a party to the first, but apparently not to the second, proceeding. In 1894 suit was entered against it for the recovery of taxes for the years 1893 and 1894, which case went to the court of appeals of the state and that court, following its decision in the second *Bank Tax Cases,* held that the taxes were collectible and remanded the case (57 S. W. 787; 60 S. W. 19). While the latter case was on appeal, and before the opinion was rendered, the authorities undertook to collect the taxes for the years 1895 to 1898. An injunction was granted by the United States Circuit Court for the District of Kentucky, on the ground that the first adjudication in the bank's favor was *res judicata* of the issue. *Bank of Kentucky v. Stone,* 88 Fed. 383. The bank thereupon amended its original pleadings in the state court case, which had in the meantime been remanded, to set up the judgment of the United States Circuit Court as *res judicata.* The court of appeals of Kentucky held that the federal court judgment did not constitute a bar because the state court case upon which it rested had been reversed (65 S. W. 10). From this deci-

sion an appeal was finally prosecuted to this Court, which in *Deposit Bank v. Frankfort, supra,* held that although the decisions of the courts of Kentucky made it clear that the banks of that state were not entitled to exemption from taxation under the act of 1892, nevertheless, in so far as the Deposit Bank of Frankfort was concerned the decision of the United States Circuit Court sustaining its right to exemption from taxation was *res judicata* of the question of its liability for subsequent years.

The instant case is, after all, closely analogous in principle to *Bissel v. Spring Valley Township,* 124 U. S. 225, and not to *Cromwell v. Sac County,* 94 U. S. 351, cited by the petitioner. In *Cromwell v. Sac County,* the first suit on certain bond coupons involved the question of fraud in the sale of the bonds. In the second suit on different coupons of the same bonds, the question was whether the plaintiff was a holder for value. As a different issue was thus raised upon a different demand, there was no estoppel.

But in *Bissel v. Spring Valley Township,* where in the first suit on certain bond coupons it was adjudicated that the bonds were void by reason of forged signatures, and in the second suit, on different coupons of the same bonds, the plaintiff offered evidence not introduced in the prior case to show that the signatures were not forged, this Court held that the previous judgment operated as an estoppel, and said (p. 236):

> "In the former action against the present defendant the adjudication was that the bonds themselves were never signed by the proper officers. * * * Their invalidity equally affected the coupons attached to them, and not merely those in suit, but all others."

In the present case the prior adjudication was that the respondent is entitled to amortize the discount in question for income tax purposes. That decision applied not only to the years then in suit, but to subsequent years as well. The Government should, therefore, be estopped from again contesting the issue, whether under the guise of offering new evidence, or in seeking through this proceeding to obtain a reversal of the former adjudication.

No convincing reason is advanced on behalf of the Government for repudiation of the principle of *res judicata*. Judgments in income tax cases deserve the same sanctity as judgments in other tax cases, or cases in general. If, as contended, the prior judgment of a lower court would become a means of discrimination in favor of a particular taxpayer when there is a later decision to the contrary by this Court, the Government can avoid the situation. If it exercises its full legal remedies in such instances, as it should do where the rights of many tax payers will be affected by the decision, the law thus laid down will be binding upon all. Judgments procured by taxpayers, it must be assumed, are generally correct. And when the Government decides not to appeal from a judgment procured by a taxpayer, it does so in full knowledge of the principle that the rights of the particular taxpayer, as established thereunder, are permanent. As to the instant case, if the prior judgment had been adverse to the respondent, it is hardly to be denied that it would have permanently settled the issue here again involved, adversely to the respondent. The judgment should be given like effect against the Government.

II.

THERE IS NO SUCH DIFFERENCE OF PARTIES AS RENDERS INAPPLICABLE THE PRINCIPLE OF RES JUDICATA.

Identity of parties is conceded by the petitioner as to No. 4174 and No. 4177 (Record, p. 1) of the present consolidated cases, which relate, however, only to the year 1920. The Commissioner of Internal Revenue was the defendant in the former case and the United States of America was the defendant in the above mentioned cases.

The Collector of Internal Revenue is the defendant, however, in No. 4172 and No. 4469, which cover the years 1921 to 1925, inclusive. It is suggested by the petitioner, though apparently not urged, that there may be lack of identity of parties as to these cases, inasmuch as the former proceeding was against the Commissioner of Internal Revenue.

This distinction is nominal only. Since a judgment against a collector, being personal in its nature, is not binding upon the Government, *Smietanka v. Indiana Steel Co.*, 257 U. S. 1; *Sage v. United States*, 250 U. S. 33, *a fortiori* can it not operate by way of estoppel in a subsequent proceeding against the Government. While Congress early enacted that judgments against the collectors may be assumed by the Government in the manner provided, and that no execution shall issue against a collector where there was probable cause for the act done by him, these provisions do not alter the fact that "the suit is personal, and its incidents, such as the nature of the defenses open and the allowance of interest, are different." *Sage v. United States, supra*, p. 37.

But the same considerations do not apply where the prior judgment was against the Government, and the

subsequent proceeding, involving the same issue, is against the collector in his official capacity. For there the defenses would be precisely the same, and there would be but a retrial of the matter formerly adjudicated. The collector in such a situation is defending the suit for the Government and stands in the stead of the Government. There is no reason why, in that situation, the prior adjudication against the United States should not operate as an estoppel in the subsequent proceeding, even though the collector, rather than the United States, may be the nominal party. As stated by the court below (Record, p. 56):

> "Taxes erroneously collected by a collector of internal revenue are received by him in his capacity as an agent of the United States, and if it has been subsequently determined by the judgment of a court that his principal was not entitled to receive them the agent is bound by the judgment and may not contest the point anew. See Second National Bank of Saginaw vs. Woodward, 54 F. (2d) 672; Bertelsen vs. White, 58 F. (2d) 792. The judgment of the District Court is affirmed."

III.

THE APPLICABLE REVENUE ACTS AND REGULATIONS ENTITLE RESPONDENT TO THE DEDUCTIONS, ALTHOUGH ITS PREDECESSOR ISSUED THE BONDS.

There is no contention that bond discount is not a deductible item. The petitioner contends, however, that the right to such deduction is limited by the regulations to the corporation which issued the bonds, and does not, under any circumstance, extend to a successor corporation. Before discussing this contention we briefly outline the facts, which are more fully set forth in the petitioner's brief, and in the record (Record, p. 30, *et seq.*).

Of the total discount of Three Million Six Hundred Thirty-eight Thousand Four Hundred Fifty-one Dollars

and Sixty-seven Cents ($3,638,451.67), the amount of Three Million Twenty-one Thousand Three Hundred Fifty-one Dollars and Sixty-seven Cents ($3,021,351.67) arose from the sale of the bonds in question by Western Maryland Rail Road Company, generally referred to as Company No. 1. The remaining portion of the discount, in the amount of Six Hundred Seventeen Thousand One Hundred Dollars ($617,100.00), arose from the sale of the bonds in question by The Western Maryland Railway Company, generally referred to as Company No. 2. This latter discount is also separately dealt with below.

Western Maryland Rail Road Company was placed in receivership on March 5, 1908, pending a reorganization to accomplish certain readjustments between the two classes of bondholders and the stockholders. A new corporation was created for the purpose and the entire assets of the old company conveyed to it, through the medium of a reorganization committee. The first mortgage bonds in question remained outstanding and were assumed as the primary obligation of the successor (and later by the respondent in the consolidation of 1917). There were second mortgage bonds of the first company in the amount of Ten Million Dollars ($10,000,000.00) which were retired with preferred stock of the second company. The holders of the second mortgage bonds were permitted to purchase a certain amount of the common stock upon specified terms, and the stockholders of the first company were given a share of the new stock for each share of the old held by them, upon payment of forty dollars per share. With this internal readjustment and corporate change, the property was operated as before. (Record, p. 30).

The bonds were sold by the first company over the period from October, 1902 to December, 1908, and One

Million Two Hundred Sixty Thousand Three Hundred Seventy-five Dollars ($1,260,375.00) of the discount in question arose from the sale of a portion of the bonds while the property was actually in the hands of the receiver and the reorganization plans presumably were being worked out. (Exhibit D, pp. 19, 32).

It is the foregoing reorganization which the Government largely relies on as defeating the respondent's right to the deduction. It is the Government's sole contention, in this connection, that the regulations allowing discount as a deduction apply only to the corporation which actually issues the bonds. The applicable provision, which has been reenacted from time to time, in Regulations 45, Sec. 544(3)(a), issued under the 1918 Act, Regulations 62, Sec. 545(3)(a), issued under the 1921 Act, and Regulations 65, Sec. 545(3)(a), issued under the 1924 Act, is as follows:

> "If bonds are issued by a corporation at a discount the net amount of such discount is deductible and should be pro-rated or amortized over the life of the bonds."

The identical provision has appeared in each of the successive regulations to date. It is also provided (Reg. 45, 62, 65, Art. 563):

> "If it (the corporation) sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid. * * *"

These regulations must be regarded as correctly expressing the congressional intent, by reason of the repeated re-enactment without change of the statutory provision allowing deduction of interest, under which the regulations were issued. *Old Colony Railroad Co. v.*

Commissioner, 284 U. S. 552; *Murphy Oil Co. v. Burnet*, No. 80 October Term, 1932.

The controversy between the petitioner and the respondent, if *res judicata* is not to apply, is, therefore, whether the applicable revenue acts and the above quoted regulations limit deductions for the amortization of discount to the corporation which issues the bonds. As the provisions clearly are not expressly so limited, the remaining inquiry is whether reasons exist which require the narrow construction contended for by the Government.

There first arises the natural inquiry why, if the regulations were intended to be thus limited, they did not so state. As they do not so state, the respondent should be entitled to the benefit of the rule repeatedly applied by this Court that in a tax statute the "construction most favorable to the taxpayer" is to be adopted. *Old Colony Railroad Co. v. Commissioner, supra; Miller v. Standard Nut Margarine Co.*, 284 U. S. 498.

Apart from this consideration, it is difficult to discover any sound reason why the regulations should be so restricted. Considering the nature of discount and the position which the respondent occupies with respect to that in question, the principle which justifies amortizing the discount for income tax purposes by the issuing company equally applies to the successor company which takes over the mortgaged property and assumes payment of the bonds and interest.

To be more specific, in the present case the respondent's predecessor, desiring to raise approximately Forty-three Million ($43,000,000.00) Dollars through the sale of its First Mortgage 4% Bonds, found that they could not be

sold at par and that it was necessary to sell Forty-six Million Six Hundred Thirty-three Thousand ($46,633,000.00) Dollars face value thereof to realize the desired amount. It is conceded by the petitioner that, had there been no reorganization, the regulations in question would have authorized the respondent's predecessor to amortize the discount. The basis for the deduction is that discount is, in effect, deferred interest. Now that the property has been taken over by the respondent and the payment assumed by it of the bonds and interest, does not the underlying reason for allowing the deduction to the issuing company require that it be allowed to the respondent? It is clear that the respondent stands in precisely the same situation that its predecessor did with respect to the property acquired by the proceeds from the sale of the bonds, which is mortgaged to secure the bonds, and to the obligation created by the bonds, and that when the respondent ultimately pays the discount it will emerge in exactly the same financial situation, as a result of the transaction, as would its predecessor if there had been no reorganization. The reason for allowing the deduction is not the mere issuing of the bonds at a discount, but the fact that the cost of the borrowed money, which the discount represents in part, must ultimately be paid. The respondent having taken over the property and assumed payment of the bonds, the debt has become its own. The respondent is currently paying the cost of the money which the stipulated interest represents, and it will pay the cost which the discount represents when it pays the bonds at par. There is exactly the same reason, therefore, why the respondent should take the deduction as if it had actually issued the bonds in the first instance,

instead of assuming them later. As the discount may not be deducted wholly in the year when it is paid, the regulations should be construed to permit the deductions in question.

Stated in another way, there is in effect one business upon which the bonds and the discount constitute an obligation, although it has been conducted successively by more than one corporation. The Court should, in our view, look to the substance of the matter and allow the deduction for the cost or loss to the business which sustains it. *Industrial Cotton Mills v. Commissioner,* 61 Fed. (2d) 291.

The Government's contention that the right does not extend to a successor company would perhaps be tenable if the transaction had been accomplished in such manner as to relieve the respondent of any obligation with respect to the bonds, but it should have no application to the situation which actually exists.

IV.

THE RESPONDENT IS, IN ANY EVENT, ENTITLED TO DEDUCT FOR THE DISCOUNT IN THE SALE OF THE BONDS AFTER THE 1910 REORGANIZATION.

If the foregoing contention on behalf of the respondent is correct, it is unnecessary to consider the 1917 consolidation. If, however, this Court should hold that the principle of *res judicata* is not applicable, and that the 1910 reorganization cut off the right to the deduction, there arises the further question whether the respondent is not, in any event, entitled to deduct for the discount in the amount of Six Hundred Seventeen Thousand One Hundred Dollars ($617,100.00) suffered in the sale of a portion of the bonds by The Western Maryland Railway Company (Company No. 2) after the 1910 reorganiza-

tion. That question would turn upon the effect of the consolidation of 1917. The decision in the prior case was admittedly an adjudication of that question and should settle the respondent's right to deduct the discount suffered by the second company. That conclusion should follow not only because of the prior adjudication but because of the nature and effect of the consolidation, the facts pertaining to which are set forth in the record (pp. 32-34). The more essential facts are briefly:

The Western Maryland Railway Company, also a Maryland corporation, owned the entire capital stock of certain subsidiary corporations, which had been formed from time to time as a convenient method of financing the construction of certain extensions of the railroad, and operated such extensions in its own name and as an integral part of its system. In 1917 the principal company and its subsidiaries were consolidated under the laws of the states of Maryland and Pennsylvania (some of the subsidiary companies being corporations of the latter state), thereby forming Western Maryland Railway Company, the respondent.

Under Article V of the Agreement of Consolidation (Exhibit A), the consolidated company expressly assumes all obligations, agreements and stipulations set forth in the Mortgage of October 1, 1902, securing the bonds, the discount from the sale of which is in question in this case. The provision is, in part:

> "and the said consolidated corporation shall possess and may exercise each and every right and power reserved to and heretofore possessed by the constituent companies, or any of them, in respect of any such mortgage * * * including each and every right and power reserved to and heretofore possessed by Western Maryland Rail Road Company or by The

> Western Maryland Railway Company under the terms of" said mortgage * * * "including the right and power to require the certification * * * of the bonds by the Trustee, * * * and the right and power to issue and use the said bonds for the purposes and objects for which the same are reserved * * * and any such bonds and other obligations may be so issued in the name of Western Maryland Rail Road Company or in the name of the consolidated corporation as may be deemed desirable by the Board of Directors of the consolidated corporation."

Article 23, sections 33 and 34, of the Annotated Code of Maryland (1924), provides with respect to consolidation of corporations that—

> "all of the property and assets belonging to said consolidating corporations of whatsoever nature and description, and all the powers and rights and all debts and liabilities of said consolidating corporations of whatsoever nature and description, shall be devolved upon said new corporation, which shall be regarded as *substituted by operation of law in the room and stead of said consolidating corporations.*" (Italics supplied.)

In *State, Use of Dodson v. Baltimore, etc. R. R. Co.*, 77 Md. 489, 491-2, the Court of Appeals of Maryland held regarding the effect of such a consolidation that—

> "The new corporation thus created was in reality the embodiment under another name of the two formerly existing. They had been joined together in every faculty and function, and molded into an indivisible unit, with none of their rights impaired and none of their responsibilities abated. If this were not the result of the consolidation, very great inconvenience and injustice would arise. The Act of Assembly enables two corporations to consolidate upon such terms as may be agreed upon."

Article I of the Agreement of Consolidation, in the broadest and plainest terms, vests in the consolidated company all the "powers, rights, privileges, immunities, franchises and property of every name, nature and description * * * of each of the constituent companies * * *."

Indeed, The Western Maryland Railway Company and its subsidiaries may be regarded as merged prior to the consolidation, for all practical purposes, on the authority of *Southern Pacific Co. v. Lowe,* 247 U. S. 330, where the Southern Pacific Company owned the entire capital stock of the Central Pacific Company and was in actual physical possession of the latter's railways and other assets, and in charge of its operations under a lease. Dividends were declared by the Central Pacific. In discussing the relationship of the two companies, and as reflecting upon whether the dividends received by the proprietary company were taxable income, this Court relied

> "upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. *While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter, acting merely as its agent, and subject in all things to its proper direction and control.*" (Italics ours.)

This Court has, indeed, expressed the view that the identity of the constituent corporations is not lost by consolidation. *Nashua & Lowell R. R. Corp. v. Boston & Lowell R. R. Corp.,* 136 U. S. 363; *Philadelphia, Wilmington & Baltimore R. R. Co. v. Maryland,* 10 How.

376, 393; *Minot v. Philadelphia, Wilmington & Baltimore R. R. Co.* (The Delaware Railroad tax), 18 Wall. 206, 228.

While it is true that under the Maryland law a new corporate entity arises in a consolidation of corporations, it is equally clear that under the law of that state the change is a purely formal one. The new entity is "substituted by operation of law in the room and stead of said consolidating corporations." The substituted corporation is, to all intents and purposes, regarded as the equivalent of its predecessor. That is peculiarly true in the instant case, because the act done by The Western Maryland Railway Company was merely to embody with itself in one corporate structure its several wholly owned subsidiary companies. If, therefore, substance and not form is to determine tax liability, there is no escape from the conclusion that the respondent is as much entitled to deduct the discount in question as was the company which was its predecessor in form only.

Respectfully submitted,

EUGENE S. WILLIAMS,
WILLIAM C. PURNELL,
Attorneys for Respondent.

Baltimore, Md.,
May 10, 1933.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1932.

No. 842

GALEN L. TAIT, Collector of Internal Revenue,
Petitioner,

vs.

WESTERN MARYLAND RAILWAY COMPANY,
a Corporation.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF ON BEHALF OF AMICUS CURIÆ.

John J. Finnorn,
Appearing as Amicus Curiæ.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1932.

No. 842

GALEN L. TAIT, COLLECTOR OF INTERNAL REVENUE, PETITIONER,

vs.

WESTERN MARYLAND RAILWAY COMPANY, A CORPORATION.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF ON BEHALF OF AMICUS CURIÆ.

Opinions Below.

The opinion of the District Court for the District of Maryland (R. 38-45) is reported in 53 F. (2d) 211. The opinion of the Circuit Court of Appeals for the Fourth Circuit (R. 52-56) is reported in 62 F. (2d) 933.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered January 13, 1933 (R. 57). Petition for a writ of certiorari was filed April 7, 1933, and was granted April 24, 1933. The jurisdiction of this Court rests upon Section 240(*a*) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

This brief will discuss only one question:

Whether the defendant, Collector of Internal Revenue, was privy to an earlier judgment rendered by the Board of Tax Appeals in a proceeding between the plaintiff and the Commissioner of Internal Revenue, involving other tax years, which proceedings were commenced more than two years after the exaction now alleged to be illegal.

Statement.

This consolidated cause was brought in the District Court to recover alleged overpayments of income tax for the calendar years 1920 to 1925, inclusive.

The tax sought to be recovered amounted to $56,557.36 and was divided for the years, and in the amounts following, to-wit:

1920	$8,079.62
1921	8,079.62
1922	10,099.53
1923	10,099.53
1924	10,099.53
1925	10,099.53
Total (R. 24)	$56,557.36

Of the total amount of $56,557,36, set forth above, the amount of $8,079.62, applicable to the year 1921, was paid in four equal quarterly instalments, to-wit: On or about April 15, June 21, September 15 and December 15, 1922 (R. 36); and the amount of $10,099.53 for the year 1922 was paid in four equal instalments on March 15, June 16, September 24 and December 15, 1923 (R. 36).

On the trial of the cause the plaintiff submitted in evidence, as conclusive proof of certain facts, a certain judgment of the Circuit Court of Appeals for the Fourth Circuit, which reversed the judgment of the United States Board of Tax Appeals in a case brought by the plaintiff against the Commissioner of Internal Revenue. *Western Maryland Railway Company* v. *Commissioner,* 33 Fed. (2d) 695.

The Board of Tax Appeals was created by the Revenue Act of 1924, which was enacted and became effective June 2, 1924.

The prior suit, the judgment in which was submitted in evidence herein, was, of necessity, commenced after June 2, 1924, and was between the present plaintiff and the Commissioner of Internal Revenue.

The only question considered here is whether Galen L. Tait, the defendant Collector of Internal Revenue, was privy to the prior judgment and bound thereby.

Summary of Argument.

This Honorable Court has twice held that no privity existed between the Collector of Internal Revenue and the United States: *Sage* v. *United States,* 250 U. S. 33; 39 S. Ct. 415; 63 L. Ed. 828; or the Commissioner

of Internal Revenue, *Bankers' Pocahontas Coal Co.* v. *Burnett*, reported in the *Supreme Court Reporter* advance sheets of December 15, 1923, Vol. 53, page 150.

In each of these earlier cases the first suit was against the Collector. The court in the instant case attempts to hold that the rule laid down by this Honorable Court in the *Sage case* and in the *Bankers' Pocahontas Coal Company case* does not apply, simply because here the first suit was against the Commissioner of Internal Revenue.

It appears that the principles of the doctrine of *res judicata* have been confounded with the general principles of the law of agency, and that sight has been lost of the fundamental principles which underlie the right to maintain a cause of action against a collector of internal revenue in the first instance.

A suit against the Collector of Internal Revenue for the recovery of taxes illegally exacted by him is personal. *Sage* v. *United States*, 250 U. S. 33, 39 S. Ct. 415; 63 L. Ed. 828; *Graham & Foster* v. *Goodcell*, 282 U. S. 409, 51 S. Ct. 186, 75 L. Ed. 415; *Smietanka* v. *Indiana Steel Co.*, 257 U. S. 1, 42 S. Ct. 1, 66 L. Ed. 99; *Union Trust Co.* v. *Wardell*, 258 U. S. 637, 42 S. Ct. 393, 66 L. Ed. 753; *Bankers' Pocahontas Coal Co.* v. *Burnett*, *Supreme Court Reporter* advance sheets, December 15, 1932, Vol. 53, page 150; *Lederer* v. *McGarvey*, 271 U. S. 342, 46 S. Ct. 534, 70 L. Ed. 977.

The personal nature of a suit against a collector, in its final analysis, results from the fact that the scope of his authority is never merely apparent but is in all cases only real. He has such authority, and only such authority, as Congress by statutory enactment confers upon him. Congress prescribes the tax, which

it is his duty to collect; if he exacts more than is prescribed, he thereby transcends his authority, and in doing so, like any other agent who exceeds the scope of his authority, makes himself personally liable.

This fact and this fact alone can support the rule established by this Honorable Court in the cited cases.

The origin of suits against officers of the Government to recover for acts done by them in their official capacity, was considered by Mr. Everett P. Wheeler, in a brief filed, as amicus curiæ, in the case of *United States* v. *Emery, Bird, Thayer Realty Co.*, 237 U. S. 28, 39 S. Ct. 499, 58 L. Ed. 825, in which he wrote:

"The argument for the plaintiff in error in this case overlooks the origin of suits against officers of the Government to recover for acts done by them in their official capacity. The origin is that: At common law the maxim was that the King could do no wrong. It followed that no suit could be maintained against him. When, however, an officer of the King transcended his authority and did something to a citizen which was in violation of law, the benefit of this maxim was not extended to the officer. On the contrary, the courts were astute to protect the rights of the injured citizen and to assume that the illegal acts, while within the apparent scope of his authority, were not really authorized by the sovereign. Of this character is the following: *Hall* v. *Smith*, 2 Bing. 156, 9 J. B. Moore 266, 2 L. J. C. P. 113.

It commonly happened that, in such cases, the Government defended the suit and indemnified the officer whose acts were drawn in question; but this circumstance did not affect the theory of the suit. *De Lima* v. *Bidwell*, 182 U. S. 1, 177, 45 L. Ed. 1041, 1048, 21 S. Ct. 743.

The same rule was adopted by the United States as part of the common law which our ancestors brought to this country, and the exemption from suit was held to extend to the United States Government and to the government of each state; but, conversely, it was held that an officer of the Government who transcended his power or committed an act colore officii was personally liable. *Meigs* v. *M'Clung*, 9 Cranch 11, 3 L. Ed. 639; *Osborn* v. *Bank of United States*, 9 Wheat. 738, 6 L. Ed. 204; *United States* v. *Lee*, 106 U. S. 196, 27 L. Ed. 171, 1 S. Ct. 240; *Britton* v. *Butler*, 9 Blatchf. 457, Fed. C. No. 1903; Story Agency, Sections 319-B, 320.

Among suits that were brought against officers of the United States Government, to recover for acts alleged to be in violation of law, were suits against Collectors of Customs who had levied taxes upon

It follows that a court having jurisdiction of a suit against a collector of internal revenue can not assume, as did the court in the case of *Second National Bank of Saginaw* v. *Woodworth*, 54 Fed. (2d) 672, that the act of the Collector was within the scope of his authority, for to do so is to beg the very question presented for determination. If the act is within the scope of his authority, he can not be said to be liable, for in that case the exaction must necessarily be held to have been authorized by the sovereign. If it was authorized by the sovereign, unless otherwise unconstitutional, the exaction can not be said to be illegal. If the exaction was not illegal, no recovery can be had.

But aside from this fact, we respectfully submit that the mere relationship of principal and agent does not *per se* give rise to privity in the sense that that term is used in the doctrine of *res judicata*.

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imports alleged to be erroneous and excessive. In such cases they sought the benefit of the rule that a voluntary payment, even if erroneously made, could not be recovered, and that an agent who had collected money for his principal and paid it over to the principal, was not liable to suit even though it should appear that the payment was erroneously made, unless he had been notified not to pay and that a personal claim would be made against him. For this reason it was held that no suit could be maintained against the Collector of Customs to recover duties levied by him in excess of the legal amount, unless he had been notified that the exaction was illegal and that a suit would be brought against him to recover the amount claimed to have been unlawfully demanded. *Elliot* v. *Swartout*, 10 Pet. 137, 9 L. Ed. 373.

At a subsequent period the Parliament of Great Britain and the Congress of the United States passed acts which were designed to remedy this in the common law, and to give to the persons injured by the action of Government officials, within the scope of their authority, a direct remedy against the Government itself. *United States* v. *Lee*, 106 U. S. 196, 205, 27 L. Ed. 171, 176, 1 S. Ct. 240."

Freeman on Judgments is unquestionably one of the most respectable of the authorities on the subject of *res judicata*. Freeman states that although privies are classified as privies in law, privies in blood and privies in estate, all privies are in effect, if not in name, privies in estate.

The subject of privies is discussed in Freeman on Judgments (5 Ed.), Sec. 438, page 958, Vol. 1, and the substance of the discussion is that unless property or rights of property are involved, there is no privity.

It is said:

> "The term privity denotes mutual or successive relationship to the same rights of property. * * *
>
> * * * All privies are in effect, if not in name, privies in estate. They are bound because they have succeeded to some estate or interest, which was bound in the hands of its former owner; and the extent of the estoppel, so far as the privity is concerned, is limited to controversies affecting this estate or interest. * * *
>
> To the extent and only to the extent to which one person has succeeded to an estate or interest formerly held by another can there be privity between them, no matter what were or are their relations to each other or to the same property. * * * There is no privity between husband and wife, or parent and child or other relatives, when neither of them has succeeded to an estate or interest in property formerly held by the other. * * * The same is true of relations created by contract such as master and servant and principal and agent or principal and surety."

This rule is one of universal application.

Allred v. *Smith*, 135 N. C. 443, 65 L. R. A. 924, 47 S. E. 597; *Lipscomb* v. *Postell, et al.*, 38 Miss. 476, 77 Am. Dec. 651; *Downey* v. *Seib*, 185 N. Y. 427, 113 Am. Stat. Rep. 926, 8 L. R. A. (N. S.) 49, 78 N. E. 66; *Hart* v. *Moulton*, 140 Wis. 349, 78 Am. Stat. Rep. 881, 80 N. W. 599; *Old Dominion Copper Mining & Smelting Company* v. *Bigelow*, 203 Mass. 159, 40 L. R. A. (N. S.) 314, 89 N. E. 193, affirmed by this Honorable Court, 225 U. S. 111, 56 L. Ed. 1009, 32 S. Ct. 614.

The corollary of this rule is the rule which this Honorable Court, quoting Freeman on Judgments, expressed in *Dull* v. *Blackman*, 169 U. S. 243, 18 S. Ct. 333, 335, 42 L. Ed. 733, as follows:

> "It is well understood though not usually stated in express terms in works upon the subject, that no one is privy to a judgment whose succession to the rights of property thereby affected occurred previously to the institution of the suit."

In the case of *Hunt* v. *Havin*, 52 N. H. 162, the court incorporated these two rules into a single definition and stated:

> "A privy is one holding under a party litigant and deriving title subsequent to the commencement of the suit."

If we apply this definition of a privy to the defendant Collector in the instant cause, we find that he does not fall within its terms, since the tax for the years 1921 and 1922 were collected by him more than two years before the commencement of the suit which re-

sulted in the judgment which forms the basis of the plea of *res judicata* herein.

Indubitably, privity in the doctrine of *res judicata* is a rule of property and property rights. It is based upon the ground and solely upon the ground that no one can transfer a greater right than he himself has. This being so, it follows that after a person has divested himself of the title or right or interest, as the case may be, nothing that he can do or suffer after the divesture can affect the rights of the party to whom the property was transferred. By the same token nothing that his transferee does or suffers can affect the transferor.

A few of the many cases that have recognized and applied this doctrine are:

> *Keokuk & Western Railroad* v. *State of Missouri*, 152 U. S. 301, 38 L. Ed. 450, 14 S. Ct. 492; *Campbell* v. *Hall*, 16 N. Y. 575; *Old Colony Trust Company* v. *City of Omaha*, 230 U. S. 100, 57 L. Ed. 410, 419, 33 S. Ct. 967; *Louisville Trust Company* v. *Cincinnati*, 22 C. C. A. 334, 47 U. S. App. 36, 78 Fed. 296; *Keokuk Railroad* v. *Scotland County*, 152 U. S. 318, 322, 14 S. Ct. 605, 38 L. Ed. 457; *Dull* v. *Blackman, supra; Carroll* v. *Goldschmidt*, 33 Fed. (C. C. A. 2) 508, 509; *Norton* v. *San Jose Fruit Packing Company*, 83 Fed. (C. C. A. 9) 512; *Farmers Loan & Trust Company* v. *Meridian Water Works Company, et al.*, 193 Fed. 661, 666; *Wicomico County Commissioners* v. *Bancroft*, 135 Fed. (C. C. A. 4) 977, 980; *Illinois Trust & Savings Bank* v. *City of Des Moines*, 224 Fed. 620, 622; *Postal Telegram & Cable Company* v. *City of Newport, Kentucky*, 247 U. S. 464, 62 L. Ed. 1215, 38 S. Ct. 566.

SUMMARY.

In summarizing the facts and the law in this suit we first say that the case must be judged by its possibilities at its commencement. See *Smietanka* vs. *Indiana Steel Co.*, 257 U. S. 1, 42 S. Ct. 1, 66 L. Ed. 99, where the suit against the defendant collector was dismissed even although a certificate of probable cause had been issued, thereby converting the claim into one against the United States. And compare *Second National Bank of Saginaw* vs. *Woodworth*, 54 Fed. (2) 672, where it was held that privity existed only because no reason to deny a certificate of probable cause appeared.

With this first proposition before us we find that the cause of action against the defendant Collector is based solely upon the assumption that he transcended his authority when he exacted the tax sought to be recovered; that his authority to collect any tax whatsoever depended upon the statute which he was administering when he made the exaction; that the statute did not authorize the exaction, hence, to the extent that he exacted more than the statute prescribed, he transcended his authority and incurred a personal liability. Certainly this constitutes the sum and substance of the issues joined.

What was the proof to establish the issue? Only a judgment rendered in a proceeding to which the defendant was not a party; a proceeding had before the Board of Tax Appeals, a tribunal that is designated by statute as an independent branch of the Executive Department, that has only special and limited jurisdic-

tion; a proceeding in which the defendant could not have appeared even had he so desired; and which was begun several years after the act complained of had been committed.

The tax for the years 1921 and 1922 was collected not later than December 15, 1923. The liability of the defendant collector was incurred, if at all, only by making the collection. His interest in the property which is the subject of this suit arose not later than December 15, 1923. Since the suit, which resulted in the judgment that was received as conclusive evidence against the defendant, was commenced before the Board of Tax Appeals, and that Board did not come into existence until after June 2, 1924, it follows that the interests of the defendant in the property here involved arose prior to the commencement of the suit pleaded in bar and he cannot, therefore, be said to be privy to the judgment.

Conclusion.

The decision of the court below is erroneous and should be reversed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 842.—October Term, 1932.

Galen L. Tait, Collector of Internal Revenue, Petitioner, *vs.* Western Maryland Railway Company.	On Writ of Certiorari to the Circuit Court of Appeals for the Fourth Circuit.

[May 29, 1933.]

Mr. Justice Roberts delivered the opinion of the Court.

Between the years 1902 and 1908 The Western Maryland Rail Road Company, a Maryland corporation, sold and issued at a discount, large amounts of its first mortgage bonds. In foreclosure proceedings under a second mortgage its entire property was sold to a reorganization committee representing second mortgage bondholders, and a new company formed under the name The Western Maryland Railway Company took title to all the assets and operated the railroad. In 1911 the latter issued and sold at a discount additional bonds secured by the first mortgage of the original corporation.

In 1917 The Western Maryland Railway Company was consolidated, pursuant to Maryland statutes, with some seven subsidiaries. The new corporation so formed, named Western Maryland Railway Company, recognized as its own obligations the outstanding first mortgage bonds issued by its two predecessors. In computing this company's income tax for the years 1918 and 1919 the Commissioner of Internal Revenue refused to allow as a deduction from gross income an amortized proportion of the discount on the sales of bonds by the first and second companies. The Board of Tax Appeals sustained the ruling.[1] The Circuit Court of Appeals for the Fourth Circuit reversed the decision of the Board.[2]

In returns for 1920, 1921 and 1922 the company neglected to take any deduction for amortization of the bond discount in question. It made timely claim for refund for all three years,

[1] 12 B. T. A. 889.

[2] 33 F. (2d) 695.

and, upon denial, brought a suit for the amount claimed against the petitioner, as collector; and also sued the United States for refund of the alleged overpayment for 1920. Deductions taken on the same ground for 1923, 1924 and 1925 were disallowed by the Commissioner, the resulting deficiencies in tax were paid under protest, claims for refund filed and disallowed, and suit brought against the petitioner as collector. The District Court consolidated the cases and tried them without a jury on an agreed stipulation. That court found that no facts were presented which had not been before the Board of Tax Appeals in the litigation over the 1918 and 1919 taxes, that the parties were concluded by the former decision, and rendered judgment for the respondent,[3] which the Circuit Court of Appeals affirmed.[4]

The petitioner seeks a reversal on the merits, asserting that a judgment in a suit concerning income tax for a given year cannot estop either of the parties in a later action touching liability for taxes of another year. He urges further, that, if this position is not well taken, he is not concluded by the former judgment because neither the proofs nor the parties are the same as in the prior proceeding.

1. The scope of the estoppel of a judgment depends upon whether the question arises in a subsequent action between the same parties upon the same claim or demand or upon a different claim or demand. In the former case a judgment upon the merits is an absolute bar to the subsequent action. In the latter the inquiry is whether the point or question to be determined in the later action is the same as that litigated and determined in the original action. *Cromwell* v. *County of Sac*, 94 U. S. 351, 352-353; *Southern Pacific R. R. Co.* v. *United States*, 168 U. S. 1, 48; *United States* v. *Moser*, 266 U. S. 236, 241. Since the claim in the first suit concerned taxes for 1918 and 1919 and the demands in the present actions embraced taxes for 1920-1925, the case at bar falls within the second class. The courts below held the lawfulness of the respondent's deduction of amortized discount on the bonds of the predecessor companies was adjudicated in the earlier suit. The petitioner, admitting the question was in issue and decided in respect of the bonds issued by the second company, and denying, for reasons presently to be stated, that this is true as to the bonds of

[3] 53 F. (2d) 211.
[4] 62 F. (2d) 933.

the first company, contends that as to both the decision of the Court of Appeals is erroneous, for the reason that the thing adjudged in a suit for one year's tax cannot affect the rights of the parties in an action for taxes of another year.

As petitioner says, the scheme of the Revenue Acts is an imposition of tax for annual periods, and the exaction for one year is distinct from that for any other. But it does not follow that Congress in adopting this system meant to deprive the government and the taxpayer of relief from redundant litigation of the identical question of the statute's application to the taxpayer's status.

This court has repeatedly applied the doctrine of *res judicata* in actions concerning state taxes, holding the parties concluded in a suit for one year's tax as to the right or question adjudicated by a former judgment respecting the tax of an earlier year. *New Orleans* v. *Citizens' Bank*, 167 U. S. 371; *National Bank of Louisville* v. *Stone*, 174 U. S. 432; *Baldwin* v. *Maryland*, 179 U. S. 220; *Deposit Bank* v. *Frankfort*, 191 U. S. 499. Compare *United States* v. *Stone & Downer Co.*, 274 U. S. 225, 230-231. The public policy upon which the rule is founded has been said to apply with equal force to the sovereign's demand and the claims of private citizens. Alteration of the law in this respect is a matter for the law-making body rather than the courts. *New Orleans* v. *Citizens' Bank*, 398-9. It cannot be supposed that Congress was oblivious of the scope of the doctrine, and in the absence of a clear declaration of such purpose, we will not infer from the annual nature of the exaction an intent to abolish the rule in this class of cases.

We are not persuaded that the operation of the principle of the thing adjudged in tax cases will, as petitioner insists, produce serious inequalities, or result in great confusion; but any adverse consequence in the administration of the law furnishes no sufficient reason for the abandonment of a rule founded in sound policy, to the enforcement of which suitors are in justice entitled.

We cannot agree that the decision in *United States* v. *Stone & Downer* requires a reversal of the judgment. The Court of Customs Appeals had from its organization consistently held the rule of *res judicata* inapplicable to its decisions as to the classification of imported commodities for the imposition of tariff duties. For some years that court's jurisdiction of customs cases was exclusive and final, and its practice, in this respect, had come to be settled.

After Congress granted a right of review we were urged to overturn the practice and to apply the doctrine of estoppel by judgment in this class of litigation. The court refused to do so, not only because of the settled practice, but also on account of the unique character of the questions presented under the tariff acts. The ruling was justified by considerations which are absent in tax litigation; and the court mentioned and recognized the authority of the precedents for estoppel by judgment in the latter.

2. Is the question or right here in issue the same as that adjudicated in the former action? The pertinent language of the Revenue Acts is identical;[5] the regulations issued by the Treasury remained unchanged;[6] and of course the facts with respect to the sale of the bonds and the successive ownership of the railroad property were the same at the time of both trials. The petitioner suggests, however, that significant facts were stipulated in the present case which were not made to appear in the former proceeding. He shows that in the earlier case the Commissioner inadvertently stipulated that the first company "may be taken as identical" with the second, whereas in the present suit the exact devolution of title from the first to the second through the foreclosure and reorganization is definitely exhibited by the stipulation of the parties. From this he concludes that the Circuit Court of Appeals might well have reached a different result on the merits, if the former case had been more fully and accurately presented. But the Circuit Court of Appeals has found that all the facts stipulated in the present cause were before it in the former one, and we accept this finding. It holds also that the former decision was based on a view of the law quite as pertinent to the bonds sold by the first company as to those marketed by the second. The petitioner may not escape the effect of the earlier judgment as an estoppel by showing an inadvertent or erroneous concession as to the materiality, bearing or significance of the facts, provided, as is the case here, the facts and the questions presented on those facts were before the court when it rendered its judgment. Compare *Deposit Bank* v. *Frankfort*, 191 U. S. 499, 510-511. The very right

[5]Revenue Act of 1918, Sec. 234 (a) (2), 40 Stat. 1057, 1077,; Revenue Act of 1921, Sec. 234 (a) (2), 42 Stat. 227, 254; Revenue Act of 1924, Sec. 234 (a) (2), 43 Stat. 253, 283; U. S. C., Tit. 26, § 986.

[6]Regulations 45 (1920 Edition), Art. 544 (a) (3); Art. 563. Regulations 62 and 65, Art. 545 (a) (3); Art. 563.

now contested arising out of the same facts appearing in this record, was adjudged in the prior proceeding.

3. As we have seen, the demand for refund of 1918-1919 taxes was against the Commissioner of Internal Revenue. The present suits are against the United States and the Collector. Are the parties the same or in such privity that the claimed estoppel binds them? The petitioner concedes that the former judgment is, so far as identity of parties is concerned, conclusive in the suits in which the United States is now the defendant, since the Commissioner acted in the earlier suit in his official capacity and as representative of the Government. This leaves for consideration the question whether the Commissioner and the Collector are for purposes of application of the rule of estoppel, to be regarded as different parties.

In a suit for unlawful exaction the liability of a collector is not official but personal. *Sage* v. *United States*, 250 U. S. 33; *Smietanka* v. *Indiana Steel Co.*, 257 U. S. 1; *Graham & Foster* v. *Goodcell*, 282 U. S. 409, 430. And for this reason a judgment in a suit to which he was a party does not conclude the Commissioner or the United States. *Bankers Pocohontas Coal Co.* v. *Burnet*, 287 U. S. 308, 311. We think, however, that where a question has been adjudged as between a taxpayer and the Government or its official agent, the Commissioner, the Collector, being an official inferior in authority, and acting under them, is in such privity with them that he is estopped by the judgment. See *Second National Bank of Saginaw* v. *Woodworth*, 54 F. (2d) 672; *Bertelsen* v. *White*, 58 F. (2d) 792.

4. These views render unnecessary any consideration of the merits of the controversy.

Judgment affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.